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September 6 — September 12, 2010 | **businessweek.com**

Bloomberg Businessweek



PROPERTY OF CHINA

China is buying Australia's resources as fast as it can, making Australians rich—and nervous p44

great surprise, Japanese policymakers discovered that the currencies of nations that export more than they import go up—especially in crisis-wracked times, when investors seek safety. The bureaucrats also learned that companies, even those with strong Japanese roots, react to strong currencies. The Renault SA-Nissan Motor alliance, for example, recently announced it is increasing production in South Korea to cut its reliance on Japan as a manufacturing base.

Now, thanks to the glacial pace of change, Japan's relevance globally is waning. China's economy officially surpassed Japan's in size in August. The moral of this story? "Don't cry about the strong yen, fix the problem," says Naomi Fink, strategist at Bank of Tokyo-Mitsubishi UFJ in Tokyo.

2) *Japan is being overwhelmed by international forces.* At play are global trends far beyond the reach of bureaucrats in Tokyo. Yet its postwar business model worked so brilliantly that the corporate elite are reluctant to change. Ditto for a government that remains wary of immigration and empowering women to offset a rapidly aging workforce.

This delicately calibrated status quo is getting harder to maintain. Trade surplus aside, there's little economic justification for the yen's 28 percent jump against the dollar since Sept. 1, 2008.

Japan didn't fix its leaky roofs when the sun was shining prior to the 2008 collapse of Lehman Brothers Holdings. Now that the world economy is raining bad news, the nation is paying the price. So are its 126 million people and investors who bought into a revival that was more hype than reality.

2.4

TRILLION

Dollar value of decline in global equities since Aug. 10, when the Federal Reserve announced the U.S. recovery would be "more modest" than forecast

DATA: BLOOMBERG, 8/10-8/31

3) *Political paralysis is taking its toll.* There's a reason currency traders aren't living in fear that the Bank of Japan will sell yen: The nation's policymaking apparatus is more uncoordinated than ever.

Part of the problem is that Japan can't seem to hang on to a leader: If a Sept. 14 election goes badly for Kan, Japan could have its sixth prime minister in three years. "Twenty years after the bubble, it would be nice to have, if not a plan, at least a sense of urgency," says Nicholas Smith, director of equity research at MF Global FXA Securities in Tokyo. "And a leader who stayed long enough for the outside world to learn his name."

This leadership vacuum feeds deflation. In July, consumer prices excluding fresh food fell for a 17th consecutive month. The best way to get consumers to save less and spend more is to convince them the future is bright. That goes for business, too.

Such optimism is in short supply. Suzuki, for one, is speaking out with greater frequency—and greater pessimism—these days. "I want Tokyo to hear our wailing," he says. Policymakers do. It's just that they have been doing their own fair share of crying—even as the world passes Japan by.
—*William Pesek with Makiko Kitamura*

The bottom line *Japan's yen crisis is symptomatic of a major policy failure to diversify the economy and make it much less reliant on exports.*

Education

A Dearth of Work for China's College Grads

- More than a quarter of the Class of 2010 has yet to find work
- "We overemphasize theory and don't [do well at] practical skills"

The job hunt came as a shock. The 23-year-old job seeker graduated in June from a good school—Beijing University of Technology—with a bachelor's degree in materials science, a subject he figured would appeal to employers. Yet he had to go through scores of interviews and comb the online job sites endlessly before landing a job at a local trading company. Happy ending? Barely. The pay, $368 a month, is meager by Bei-

Development

Stuck: Traffic and the Global Economy

The 10-day traffic jam that clogged 60 miles of Chinese highway in August has cleared. So what's the best way to relieve global traffic? "The key is good public transit," says Robert Cervero, professor of city and regional planning at U.C. Berkeley. To Gilles Duranton, a professor of economics at the University of Toronto, the only solution is to charge drivers extra for driving during peak hours: "There's an infinite supply of people who want to be on the road." —*Caroline Winter*

42% of Moscovites reported being stuck in traffic for over three hours at some point in the last three years.

34% of drivers in New York City said that aggressive/rude drivers are the most frustrating part of their commutes.





A Wuhan job fair for grads: What students learn isn't what companies need

jing standards, so he has had to move back in with his parents and he's too ashamed about the outcome of his job search to give his name. As the young man explains, there are too many recent grads looking for jobs, while companies want only the most qualified people at the lowest price.

At least he got a job—many of his peers are still looking. Even as labor shortages plague manufacturing industries, more than one-quarter of this year's 6.3 million Chinese college graduates are unemployed, according to the Education Ministry.

The problem of graduate unemployment and underemployment has been building for years, due to rising university enrollments and a mismatch between what students learn and the skills companies need. About a decade ago, the government decided to boost university admissions, a move that policymakers believed would yield big economic benefits as China shifted to an economic model based more on innovation than on cheap manufacturing. Since 1998 the number of graduates has risen threefold, according to Zeng Xiangquan, dean of the School of Labor Relations and Human Resources at Renmin University of China in Beijing.

The expanded enrollment has slowed down salary increases for entry-level white-collar jobs. Graduates in high-cost cities such as Beijing and Shanghai struggle to get by, living in crowded dormitory-like conditions. Chinese sociologist Lian Si has coined the term "ant tribe" (*yi zu* in Chinese) to describe the tens of thousands of grads subsisting in squalor on the outskirts of China's biggest cities. In an Aug. 6 commentary for *China Daily*, Yu Jianrong, a scholar at the Chinese Academy of Social Sciences in Beijing, wrote that with so many college grads marginalized, China risks creating a new class of "underdogs" who seethe with "hatred against the bureaucracy."

Foreign companies are not doing much to absorb this surplus labor. Those that take on newly minted grads typically find they "have to invest significantly in training and development to bring their new hires up to par with their peers in other countries," says a white paper published in May by the American Chamber of Commerce. "While we hire many recent graduates, of course we prefer candidates to have working experience, especially in a multinational, diverse environment," says Trevor Hale, director of corporate communications for **Ford Motor**, Asia Pacific & Africa. "In some disciplines like engineering or marketing, we would much rather have fewer people who are more senior and experienced than a greater number of less experienced people." According to Gerard A. Postiglione, a researcher on Chinese education at the University of Hong Kong, Chinese college students are not trained to work collaboratively, be creative and innovative, or take risks.

Some of these deficiencies are a product of the Communist Party's decision to model the educational system on that of the Soviet Union. After the new regime seized power in 1949, China's comprehensive universities were replaced with Soviet-style schools that

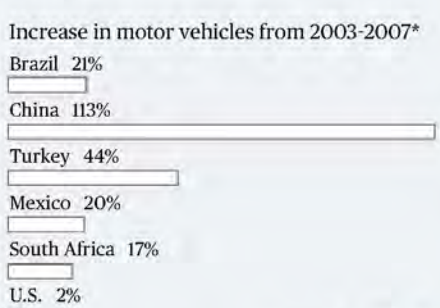
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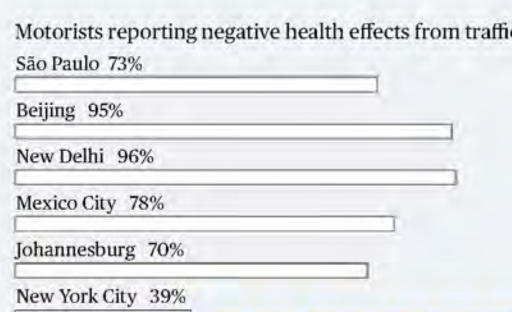
20%

of Beijing commuters said that the price of gas would have to increase by 20% before they would seriously consider alternate types of transportation.

32%

of people in Mexico City commute mostly by bus.





DATA: IBM COMMUTER PAIN INDEX SURVEY *WORLD BANK



Global Economics

churned out graduates narrowly focused on skills seen as necessary to manage a heavy-industrialized, planned economy. Academia was dealt another blow by the Cultural Revolution of 1966-76, when the Red Guards shut down all institutions of higher education and persecuted thousands of teachers and administrators.

One feature that has survived all the upheaval is the traditional emphasis on rote memorization. "The teacher stands and talks, talks, and talks. The students sit and listen, listen, and listen," says Renmin's Zeng. "We overemphasize theory and don't [do well] when it comes to the teaching of practical skills." Compounding the problem is that state-owned enterprises, which traditionally hired many college grads, have been severely downsized themselves.

The government is trying to set things right. Chinese authorities on July 29 announced a "National Plan for Medium and Long-Term Education Reform and Development" that will boost spending on education at all levels and focus university curricula more on practical skills. Outside analysts are encouraged. "The blueprint 10-year plan is very clear about the flaws in the educational system," says University of Hong Kong's Postiglione. The city of Chongqing, meanwhile, has introduced special funds and tax rebates to support graduates who set up their own businesses. The central government is urging young people with college degrees to apply for official posts in the poor interior provinces.

Already, the government is claiming a small victory of sorts, with the Education Ministry announcing recently that the rate of employment for recent graduates rose from 68 percent in 2009 to 72.2 percent this year. "As the economic structure changes, more suitable jobs for graduates will be created," says Zhang Juwei, deputy director at the Institute of Population and Labor Economics at the Chinese Academy of Social Sciences. Although Zhang may be right, that scenario is little comfort to the more than 25 percent of recent grads still hunting for work. —*Dexter Roberts*

***The bottom line** China's new university graduates lack the skills companies need, and there are too many of them, which is keeping salaries low.*

Taxation

Italy Wants to Ruin Tax Dodgers' Vacations

▶ **Undercover inspectors finger luxury boat owners as tax cheats**

▶ **"We found a person on a yacht who was listed as having no assets"**



It's been a busy summer for Italy's undercover tax inspectors. Sporting T-shirts, shorts, and flip-flops, they have blended into the crowd at beaches, yacht clubs, and discos from Venice to Sicily, searching for that most elusive of creatures, the Italian tax dodger.

Evasion is rampant in Italy. Though it's one of the world's 15 richest nations based on per-capita gross domestic product, only 0.2 percent of taxpayers declare income of more than $250,000 a year. Prime Minister Silvio Berlusconi's government is now determined to recoup $13 billion in unpaid taxes.

Summertime, when business booms on Italy's 5,000 miles of beaches, is an ideal hunting season for tax inspectors. If you're a successful Italian tax cheat, you may well have the money to buy a yacht. Tax agents can check a yacht's registration, figure out who owns it, and find out if the owners paid the kind of taxes a guy who can afford a fancy boat should pay.

With yacht owners, "sometimes we find their [declared] annual income isn't even enough to pay for a boat slip in the marina," says Luigi Magistro, who heads the assessment directorate at the Italian Revenue Agency in Rome. "In Capri, we found a person on a luxury yacht who was officially listed as having no assets and in need of welfare." Inspectors identified beach clubs on the Amalfi Coast listed as money-losing, nonprofit orga-

Misery of commuting (out of 100)
São Paulo 75
Beijing 99
New Delhi 81
Mexico City 99
Johannesburg 97
New York City 19

Average time stuck in traffic
São Paulo 1 hour and 30 minutes
Beijing 1:36
New Delhi 1:18
Mexico City 1:30
Johannesburg 1:36
New York City 0:48

16%
of respondents said they would rather work more than sit in traffic (40% in New Delhi, 25% in Mexico City, 13% in Los Angeles).





Putin as fire-fighter: A media blitz tried to showcase his competence

nizations—nonprofits that serve haute cuisine and cocktails to beachgoers who shell out $63 a day to stretch out on a lounge chair under an umbrella.

The campaign may hamper Italy's recovery from recession, according to Fabio Pesto, the head of Federagenti-yacht, which represents Italy's yacht agents. (A yacht agent charters boats for clients, brokers sales, provides crews, and so on.) Many Italians have their boats registered abroad, and they have grown skittish as word of the crackdown has spread. Through June, visits to Italy by foreign-flagged boats longer than 30 meters fell by about half from a year earlier. Pesto says owners of foreign-registered boats typically spend about $250 million a year in Italy's ports.

The sting operation does have supporters. "It's the right move," says Pino Affer, owner of a modest beach club by an artificial lake near Milan. "Here at the poor people's beach, there are no yachts, just little pedal boats and rowboats," he explains. "I pay my taxes because the little guy always has to pay, while the big fish always ends up eating the little fish, unfortunately."

—Sonia Sirletti and Jeffrey Donovan

The bottom line *Italian tax inspectors are sweeping the country's beaches and yacht clubs in a quest to recoup lost revenues from tax cheats.*

FROM TOP: ALEXEI NIKOLSKY/RIA NOVOSTI/AP PHOTO; ANDREW HARRER/BLOOMBERG

Russia

Putin After the Fires: Stronger Than Ever?

- Many citizens believe that Putin can fix what ails Russia
- "All decisions are made, and all the commands are issued at the top"

When Russian Prime Minister Vladimir Putin met on Aug. 3 with residents of a village in the Moscow region that burned to the ground in the recent wildfires, he promised to rebuild their homes before winter. To make sure, he ordered round-the-clock video surveillance on the construction sites and put monitors of the sites in his home and office.

Political analysts say Putin and President Dmitry Medvedev handled the wildfire emergency poorly. Timberland, villages, and a naval base were destroyed as officials in Moscow initially failed to act and their local subordinates were reluctant to take charge, says Nikolai Petrov, an analyst at the Carnegie Moscow Center. "All decisions are made and all commands are issued at the top, so everyone was waiting for orders from the Prime Minister."

Still, Petrov and other political analysts believe that the wildfires will result in more power for Putin. As the fires were raging, the Moscow-based Public Opinion Foundation asked 2,120 Russians living in seven affected regions to rate the performance of local and regional officials on a scale of 1 to 5. Respondents gave them average grades of 2.3 and 2.5, respectively. Putin and President Dmitry Medvedev fared better, with average grades of 3.7 and 3.6.

In the teeth of the crisis, state media portrayed Putin consoling fire victims, meeting with local officials, publicly dressing down the head of the Federal Forestry Agency, and even co-piloting a fire-fighting plane. Since the fires ended, Putin has kept up the media blitz, tagging grey whales with a crossbow, driving cross country on a new highway, and calmly examining a nearby brown bear in a Siberian stream.

During his eight years as President before Medvedev got the job in 2008, Putin systematically weakened regional leaders and billionaires who challenged him, and boosted state control of the energy, banking, and transportation industries. Putin and Medvedev have already dismissed some officials for failing to control the fires, and Putin stated in late August that the forestry agency should now report directly to him, not to the Agriculture Ministry. "They can't admit that they're incompetent," says Dmitry Oreshkin, an independent political analyst in Moscow. "So they say they're competent but don't have enough power, and they'll have to tighten the screws."

To critics including Boris Nemtsov, a Deputy Prime Minister under

Quoted

"It's time to recognize that many balance sheets in the U.S. are not just illiquid. They are insolvent. And you cannot make large levels of this private debt disappear just by waving your hand."

—Carmen Reinhart, professor of economics, University of Maryland, on the debt crisis in America



Global Economics



P&G wants your dry cleaning page 20 ▶

Boris Yeltsin, tightening the screws paradoxically shows how dysfunctional the government has become. "When Putin sticks cameras in the Vyksa district to check if materials are being stolen, he is admitting his own impotence," Nemtsov says. "This is manual control, and you can't run a country this big by hand."

Others say Russia needs that hand. Dmitry Zelenin, governor of the Tver region north of Moscow, says rebuilding houses before winter is "a serious challenge. To get it done, you have to get the higher-ups involved." If ordinary Russians agree with Zelenin, they can soon show their approval: Putin's United Russia party is contesting hundreds of regional seats in October elections.
—Ilya Arkhipov and Lyubov Pronina

The bottom line *The Kremlin did not handle the recent fires well. Yet Putin and Medvedev may still use the episode as a way to accrue more power.*

U.K. Economy

Britain's Cheap Drinkers Threaten Clubs



▶ A once-booming nightclub scene crumples as the young stay jobless

▶ "Undergraduates are not finding jobs, creating a huge strain"

A British tippler who opts to drink beer at home spends as little as 79 pence–$1.22–for a pint. At a British nightclub, a pint usually goes for £6.

That simple math appeals to young British consumers (18- to 24-year-olds) suffering from 20 percent unemployment among their age group. A growing club scene in Britain once thrived on affluent young consumers. Now many of those clubgoers are on the dole.

Luminar Group Holdings, the U.K.'s largest club owner, has shut at least 11 venues since February. Its shares have dropped 74 percent this year. **Brook Leisure Holdings**, which operates in northern England, has had to close two clubs and a bar in the past four months. "This year has been particularly tough," says Cameron Leslie, co-founder and managing director of two London clubs, one of which he closed in June. "Undergraduates are not finding jobs, creating a huge strain on our core target market."

4.4%

Year-on-year gain in supermarket beer sales in the U.K.

The number of U.K. clubs has fallen 21 percent since 2006, a decline of 622 venues, according to CGA Strategy, a supplier of trade data to the industry. "It has been happening for the last five or six years, but it has been accelerated by the recession," says Jonny Forsyth, a beverage industry analyst at Mintel International in London. "Suddenly, young people have no choice but to stay in." Average weekly household income after essential costs such as food and utility bills will be $266 in September, down 4 percent from a year earlier, according to the Centre for Economics & Business Research. Britain's worst recession is also accelerating the decline of the pub. In 2009 pubs closed at a rate of 40 a week, reports the British Beer and Pub Assn.

Dwindling disposable income has forced clubs to try desperate strategies. "No one likes going to empty nightclubs, and cutting admission prices to attract customers indicates you're in trouble," says Simon French, a London-based analyst at Panmure Gordon. "If a club is empty for one week, no one will come back the next."

Instead of a night out, many are lugging a case of beer home from **Sainsbury's** or **Tesco** and watching a football on TV. That 79-pence pint, for example, comes from Tesco, which sells its store-brand lager at rock-bottom prices. Supermarket beer sales rose 4.4 percent from the second quarter of 2009. Says Peter Marks, chief executive officer of Brook Leisure: "When the economy is tight, punters always look for value." ⓑ
—Chris Kay and Peter Evans

The bottom line *Young Britons are doing their drinking at home as unemployment among 18- to 24-year-olds hits 20 percent.*

Tom Keene's EconoChat

Tom talks with **John Silvia,** chief economist of Wells Fargo Securities, on the uncertainties hobbling the U.S. economy.

What's the view forward now?
I suspect that the Fed is going to look at the third-quarter GDP number, Tom, and it will suggest the economy is just moving sideways, so they will probably act in November and December to expand the Fed's balance sheet by buying Treasuries and mortgage-backed securities.

What would you like Obama to do?
What I would want the Administration to do is simply say: Listen, we are going to leave the Bush tax cuts in place at least for another year and remove at least that uncertainty off the table.

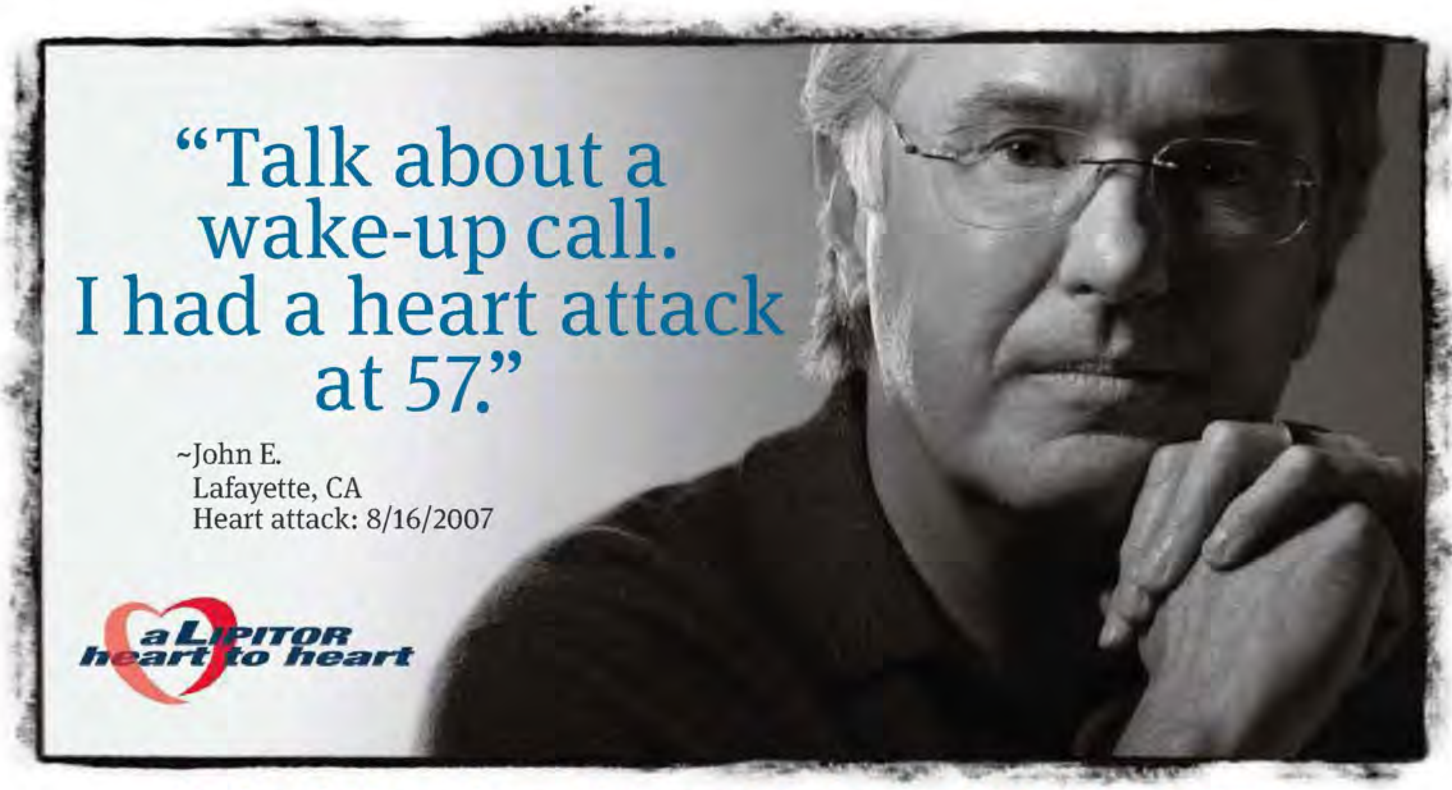
There are politics involved, though.
I understand that. Yet the economy is only growing at, let's say, 1.5 to 2 percent. That is not a big margin of error to conduct what may be perceived as a significant policy change by hiking taxes. Also, to know that your tax on dividends and capital gains is going up, you may have more of a rush to realize capital gains by the end of the year, which I think will put downward price pressure on assets.

When are we going to get above 2, 2.5 percent growth again?
My suspicion is probably in the first quarter and certainly in the second quarter of next year. I think Chairman Bernanke fairly summarized it: We are going through a healing process. Household balance sheets are improving. Home prices, yes, they are down, but gradually they are going to turn around. ⓑ



Keene hosts Bloomberg Surveillance *7-10 a.m., 1130AM in New York, XM 129, Sirius 130.*

CLOCKWISE FROM TOP: RAMIN TALAIE/BLOOMBERG; ANDREW HARRER/BLOOMBERG; CHRIS RATCLIFFE/BLOOMBERG



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If you take LIPITOR, tell your doctor if you feel any new muscle pain or weakness. This could be a sign of rare but serious muscle side effects. Tell your doctor about all medications you take. This may help avoid serious drug interactions. Your doctor should do blood tests to check your liver function before and during treatment and may adjust your dose.

Common side effects are diarrhea, upset stomach, muscle and joint pain, and changes in some blood tests.

INDICATION:
LIPITOR is a prescription medicine that is used along with a low-fat diet. It lowers the LDL ("bad" cholesterol) and triglycerides in your blood. It can raise your HDL ("good" cholesterol) as well. LIPITOR can lower the risk for heart attack, stroke, certain types of heart surgery, and chest pain in patients who have heart disease or risk factors for heart disease such as age, smoking, high blood pressure, low HDL, or family history of early heart disease.

LIPITOR can lower the risk for heart attack or stroke in patients with diabetes and risk factors such as diabetic eye or kidney problems, smoking, or high blood pressure.

Please see additional important information on next page.

LIPITOR
atorvastatin calcium
tablets

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IMPORTANT FACTS

LIPITOR atorvastatin calcium tablets (LIP-ih-tore)

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WHO IS LIPITOR FOR?

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- Adults and children over 10

Who should NOT take LIPITOR:

- Women who are pregnant, may be pregnant, or may become pregnant. LIPITOR may harm your unborn baby. If you become pregnant, stop LIPITOR and call your doctor right away.
- Women who are breast-feeding. LIPITOR can pass into your breast milk and may harm your baby.
- People with liver problems
- People allergic to anything in LIPITOR

BEFORE YOU START LIPITOR

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- If you have diabetes or kidney problems
- If you have a thyroid problem

ABOUT LIPITOR

LIPITOR is a prescription medicine. Along with diet and exercise, it lowers "bad" cholesterol in your blood. It can also raise "good" cholesterol (HDL-C).

LIPITOR can lower the risk of heart attack, stroke, certain types of heart surgery, and chest pain in patients who have heart disease or risk factors for heart disease such as:

- age, smoking, high blood pressure, low HDL-C, family history of early heart disease

LIPITOR can lower the risk of heart attack or stroke in patients with diabetes and risk factors such as diabetic eye or kidney problems, smoking, or high blood pressure.

POSSIBLE SIDE EFFECTS OF LIPITOR

Serious side effects in a small number of people:

- **Muscle problems** that can lead to kidney problems, including kidney failure. Your chance for muscle problems is higher if you take certain other medicines with LIPITOR.
- **Liver problems.** Your doctor may do blood tests to check your liver before you start LIPITOR and while you are taking it.

Call your doctor right away if you have:

- Unexplained muscle weakness or pain, especially if you have a fever or feel very tired
- Allergic reactions including swelling of the face, lips, tongue, and/or throat that may cause difficulty in breathing or swallowing which may require treatment right away
- Nausea, vomiting, or stomach pain
- Brown or dark-colored urine
- Feeling more tired than usual
- Your skin and the whites of your eyes turn yellow
- Allergic skin reactions

Common side effects of LIPITOR are:

- Diarrhea
- Upset stomach
- Muscle and joint pain
- Changes in some blood tests

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- Take LIPITOR as prescribed by your doctor.
- Try to eat heart-healthy foods while you take LIPITOR.
- Take LIPITOR at any time of day, with or without food.
- If you miss a dose, take it as soon as you remember. But if it has been more than 12 hours since your missed dose, wait. Take the next dose at your regular time.

Don't:

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- Do not start new medicines before talking to your doctor.
- Do not give your LIPITOR to other people. It may harm them even if your problems are the same.
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The Washington Post Co.'s School of Hard Knocks

▶ **A federal crackdown could hit its Kaplan education unit**

▶ **"People are noticing just how important Kaplan has been"**



ILLUSTRATION BY FRANK CHIMERO

As the newspaper industry suffered through historic lows in advertising sales and circulation in recent years, **Washington Post Co.** could always rely on its Kaplan testing and education unit to help prop up results. With the company's media business still hurting, a crackdown by the Obama Administration on student loan repayment rules could threaten Kaplan's outlook.

For-profit colleges such as those owned by Post, **Strayer Education,** and **Corinthian Colleges** rely in some cases on federal financial aid for up to 90 percent of their revenue. Yet data released by the Education Dept. last month showed that less than 35 percent of federal student loan aid is repaid at some campuses of those three college operators. The loans that aren't repaid come out of taxpayers' pockets. Congress and the Administration are proposing tougher oversight of for-profit schools amid concern that recruiters working for some of these colleges are signing up unqualified students and saddling them with loans they won't be able to repay. Regulations under consideration include rules that could make students at schools with the worst repayment records ineligible for federal loans. That could make it difficult for some for-profit colleges to survive. "This student financial aid is pretty important for for-profit colleges," said Jeffrey Silber, a BMO Capital Markets analyst. "Schools are going to have to revise some programs and seek out different types of students," if the regulations are enacted.

Kaplan operates college admissions test preparation courses as well as Kaplan University, which offers degree programs online and at campuses in Iowa, Maine, Maryland, and Nebraska. Although the *Washington Post* newspaper and its *Newsweek* magazine are better known, Kaplan has become the Post's larg-

est unit, accounting for nearly 60 percent of revenue last year, up from 11 percent 10 years ago. Kaplan's impact on profits are even greater. In 2009, Kaplan had operating income of $194.8 million, while the Post's newspaper business lost $163.5 million and *Newsweek* lost $29.2 million. (Washington Post in August agreed to sell the magazine.)

The Education Dept. data showed that for-profit colleges have an average 36 percent loan repayment rate, compared with 54 percent at public universities and 56 percent at private nonprofits. The government is considering a rule, to take effect next July, that could restrict federal grants and student loans at for-profit schools with less than a 45 percent repayment rate and prohibit aid at for-profit schools with less than a 35 percent repayment rate. The schools can also qualify for aid by showing that loan repayments don't exceed a certain percentage of former students' income. The Education Dept. has said 5 percent of for-profit programs could lose eligibility.

Washington Post Chairman Donald E. Graham, who has personally lobbied on Kaplan's behalf, says the regulations "don't have the effect they intend and, in fact, have the perverse effect of punishing schools that serve low-income students." Graham says "over 70 percent of our students are Pell Grant-eligible, which means we serve a very low-income population."

The company says the federal data showed Kaplan had a 28 percent repayment rate. A Kaplan spokesperson, Melissa Mack, says the company takes issue with the data, noting that students who defer repayment on certain loans are being counted as failing to repay. "Were schools at least not penalized for having students that participate in those programs, our percentage would increase by 20 to 30 points," says Mack.

Hal Jones, Washington Post's chief financial officer, says it's not yet clear what financial impact the proposed changes would have on Kaplan. Washington Post last month said tighter restrictions on federal education grant and loan programs could cause it to lose students and struggle to retain teachers. If it cannot lift the average repayment rate or help graduates lower their debt-to-earnings ratio, the U.S. could deny Kaplan aid, the company said.

In August the Government Accountability Office issued a report critical of recruiting tactics at 15 for-profit schools, including two Kaplan campuses. The company said it was complying with a federal request for information on financial results, recruiting, operations, enrollment, and regulatory compliance over the last four years.

The warnings about Kaplan have shaken investors in Washington Post stock, whose largest common holder is Warren Buffett's **Berkshire Hathaway**, sending the shares at one point to a 14-year low. The stock has tumbled more than 18 percent this year. Short-selling of Post shares, basically a bet that the stock price will fall, has soared to its highest level in at least 19 years. "People are noticing just how important Kaplan has been to Washington Post all these years," says Will Duff Gordon, senior analyst with Data Explorers, which tracks short sales. The company may also face higher borrowing costs. Standard & Poor's cut its outlook on Washington Post, and Moody's Investors Service is reviewing the company for a potential downgrade. —*Greg Bensinger, with John Lauerman and John Hechinger*

The bottom line *Washington Post has long profited from its lucrative Kaplan education unit. Tougher rules on loan repayments could hurt the business.*

1.5

PERCENT

The decline in 2010 attendance by U.S. moviegoers through Aug. 31. Higher ticket prices, however, boosted revenue by 4.1 percent.

DATA: HOLLYWOOD.COM BOX OFFICE



FROM TOP: CHIEN-MIN CHUNG/POLARIS; BRIAN SNYDER/REUTERS

Autos

Running Afoul of China, BYD Could Lose Plants

- The Warren Buffett-backed carmaker faces a land-use crackdown
- "Companies are watching the case closely, and it will set an example"

BYD, China's fastest-growing major automaker, will be a test case for whether the government values corn and wheat over industry. China's Land & Resources Ministry says that BYD, maker of China's top-selling compact car, the F3, unlawfully built seven factories on 112 acres of farmland it agreed to buy in Xi'an from a local economic development agency. The government said it will decide by Sept. 30 whether to punish the company, which is 10 percent owned by Warren Buffett's **Berkshire Hathaway**. Penalties could include big fines or an order to demolish the plants. China's land ministry this year already has ordered demolition or jail time in five cases of businesses that illegally built golf courses and housing developments or dug mines on farmland.



Expansion at BYD's Xi'an complex concerns Chinese officials

China is struggling to balance its pursuit of economic growth with its need to preserve enough farmland to feed its 1.4 billion people. The amount of land used illegally in the first six months of this year rose by 14 percent from a year earlier, to 77.9 million square meters (19,254 acres), the ministry said. Chinese companies seeking to expand sometimes start construction before securing government approvals, says Johnny Wong, an analyst at Yuanta Securities. One reason: The approval process to begin construction can take years to wind through China's bureaucracy.

Local officials, eager to meet development goals, often look the other way or even sell government-owned farmland to builders of new plants. China's Communist Party evaluates local officials using benchmarks that include economic growth, residents' income and education, and environmental protection, according to the assessment system distributed by the Central Organization Dept. High marks are needed for career promotion, prompting many officials to pursue economic growth over land protection, says Dang Guoying, a researcher at the Rural Development Institute of the Chinese Academy of Social Sciences in Beijing. In July, China's land ministry said that local government officials deemed complicit in five cases where building was improperly allowed to proceed on farmland have received administrative punishments.

"The illegal usage of land has been quite common," says Wang Liusheng, an analyst with China Merchants Securities in Shenzhen. "Companies, especially those developing on a fast track, were forced to do so in order to catch market opportunities." Paul Lin, a spokesman for Shenzen-based BYD, declined to discuss the possible impact on the company. "Let's see the conclusion, and we'll prepare for that," he said.

Because of BYD's size and importance in one of China's key industries, its predicament has drawn attention. "A lot of companies are watching the case closely, and it will set an example," said Zhang Xin, an auto analyst with Guotai Junan Securities in Beijing. "If the government lets BYD off the hook easily, the illegal usage of land won't be effectively controlled."

China, which consumes one-fourth of the world's grain, needs at least 297 million acres of arable land to grow enough food to feed its people, the land ministry said. Economic and social development from 1997 to 2007 reduced farmland by 83 billion square meters to about 1.22 trillion square meters. That's about 1.4 percent above the minimum requirement for arable land, says the ministry. "The ministry will severely punish violators of land-safeguarding laws and regulations, and we should dare to tackle tough cases," says Li Jianqin, head of the ministry's law enforcement and supervision division.

The ministry says BYD built its new factories even though 92 percent of the land they occupied in Shaanxi province was zoned for agriculture. The province produced 4.84 million tons of corn and 3.92 million tons of wheat in 2008. BYD's Xi'an factory, built in 2005, can assemble 300,000 cars a year. The carmaker planned to invest 5 billion yuan ($735 million) in a second factory complex in Xi'an with the same capacity. Construction started earlier this year and was expected to be finished by the second half of 2011, BYD's Lin says.

Although analysts don't expect BYD managers to receive prison time, there is financial risk for the carmaker. "If the government really means to play tough, they will order BYD to tear down whatever they have built on the land," auto analyst Zhang says. "All the other companies will really draw lessons from BYD's case and won't dare to use land illegally."
—Tian Ying and Liza Lin, with Andrew Frye, Yidi Zhao, and Chua Baizhen

The bottom line *China is taking action against companies that have built on land zoned for farming. The BYD case is being closely watched.*

Quoted

"Every company is for sale at some price. [Genzyme] is not for sale for $69. What the board needs to see, and what the shareholders deserve, is a fair value of the company."



—Henri Termeer, CEO of Genzyme, explaining why the biotech company rejected Sanofi-Aventis' $18.5 billion buyout offer last month

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sage



A CIA of Finance? page 26 ▶

Enterprise

A Sweet Dream for Young Entrepreneurs

▶ In a downturn, a wager that custom candy bars will pay the rent

▶ "We looked into chocolate and saw it was relatively recession-proof"

Will chocolate weather the recession better than the finance industry? Eric Heinbockel is betting it will. With a year as an unpaid intern at a small New York brokerage under his belt and no decent offers after applying for dozens of jobs, the 24-year-old gave up on his dream of a career in finance. Instead, last year he and two friends he met while getting his political science degree at Columbia University started **Chocomize**, an online shop that lets chocolate lovers customize their candy bars with ingredients ranging from graham crackers to gold flakes. "We looked into chocolate and saw it was relatively recession-proof," Heinbockel says.

Just as **Dell** found success by letting customers tailor-make their PCs online, Chocomize offers customized candy. The company allows buyers to choose their chocolate—milk, dark, or white—and up to five of more than 100 add-ins. Beef jerky will set you back $1.85 on top of about $4 for the bar; cayenne pepper is 75¢, dried raspberries are $1.20, and gold flakes are $3.25. One couple ordered 125 dark chocolate bars with bacon, Brazil nuts, and raisins for their wedding. "It's their day, so I guess they get to do what they want," Heinbockel says.

The Chocomize trio got turned on to chocolate after a happy accident. On a warm day in June 2009, Chocomize partner Nick LaCava, 23, left a bag of chocolate and other candy in the back seat of his car. When it all melted into a gloppy mess, LaCava's friends suggested it might be edible if he were to toss it in the freezer. He did—and loved the result. "To me, eating chocolate and gummy bears seems like the coolest thing in the entire world," says LaCava. "That's sort of when the lightbulb went off in our heads," he recalls. "All these different ingredients in chocolate. What if you could choose your own ingredients?"

LaCava, Heinbockel, and Fabian Kaempfer, 24, spent the summer learning how to make chocolate and figuring out how to start a business. When banks were unwilling to lend to three kids fresh out of college, Heinbockel's grandparents offered to help with the funding. The families of the other founders followed suit, and Kaempfer sold his car. The three eventually raised about $100,000.

By last November the Chocomize site was up and running, and it isn't just a facade for three guys making chocolate bars in the kitchen. Chocomize leases 2,000 square feet in Cherry Hill, N.J., where the company has some $40,000 worth of equipment such as tempering machines and a big refrigerator. In addition to the founders, Chocomize

FROM LEFT: LARRY DOWNING/REUTERS; PHOTOGRAPH BY MARTHA CAMARILLO FOR BLOOMBERG BUSINESSWEEK





At Chocomize: Using cornflakes to customize chocolate bars

has three full-time chocolate makers and two who come in when needed. The company has sold some 50,000 bars in the past nine months and can produce about 4,000 bars a week (Chocomize usually makes half that, but expects orders to jump during the holidays). Heinbockel says the company became profitable in March, and he hopes to top $1 million in sales this year.

Chocomize has at least one entrenched rival. Berlin-based **Chocrí** has been offering a nearly identical product in Europe since 2008. It expanded in January into the U.S., where it's already profitable, says its U.S. boss, 25-year-old Carmen Magar, a recent graduate of the University of Chicago Booth School of Business. Chocrí, with 25 employees, makes 50,000 bars a month. "I think our extensive experience does give us a competitive advantage" over Chocomize, Magar says. Plus, she notes, Chocrí offers unique add-ins such as "candied rose petals from a tiny little farm in Austria in the middle of nowhere."

Joe Pine, author of *Mass Customization: The New Frontier in Business Competition* and co-founder of the consultancy Strategic Horizons, says custom chocolate is a good way for a small player like Chocomize to differentiate itself in the market, because it's a niche that mass chocolate makers like **Hershey** will likely ignore. While the Chocomize founders have big dreams, their made-to-order strategy may ultimately limit the company's potential. "It's a customized product, so by definition it can't go into" supermarkets or stores where consumers might pick up a bar while they're waiting in the checkout line, says James Targett, senior analyst for global food manufacturing at London-based Consumer Equity Research. "The whole business model is to be individual." —*Zachary Tracer*

The bottom line *After failing to land decent jobs in finance, a trio of recent grads decided to launch a company that makes customized chocolate bars.*

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Divya Gugnani owns the culinary web company Behind the Burner; and for her, Booming is getting paid faster. After using social media to reach 140,000 subscribers in just two years, Divya needed her cash to flow as rapidly as her company was growing. So she started invoicing with AcceptPay,® a new online payment solution from American Express OPEN. Now her advertisers have more ways to pay, and she's getting paid around three weeks faster. Get your business Booming at open.com.

DIVYA GUGNANI
BEHIND THE BURNER
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Consumer Products

P&G Puts Its Big Brands To Work in Franchises

▶ The marketing giant tries its name on dry cleaners and car washes

▶ "The brand Mr. Clean has huge value for attracting customers"

Procter & Gamble, long dominant in detergents to wash clothes, wants to dry clean them, too. The world's largest consumer products company plans to roll out franchised Tide Dry Cleaners across America. Some franchising vets say the strategy could be a hit. Andrew Cherng, founder of **Panda Restaurant Group**, which operates Chinese fast-food outlets in U.S. malls, plans to open about 150 Tide-branded dry cleaners over the next four years. "I wasn't around when McDonald's was taking franchisees," he says. "I'm not going to miss this one."

P&G wants to put its brands to work selling services to boost U.S. revenue and promote its products. Three years ago the company launched Mr. Clean Car Wash; nine franchisees are now in business. In 2008, P&G opened three test Tide Dry Cleaners in Kansas City. Having fine-tuned the concept, the company is now going national. P&G is moving into services "that are virtually unbranded," says Michael Stone, head of The Beanstalk Group, a brand-consulting firm. "One would think consumers would trust a Tide Dry Cleaners because they know P&G is behind it."

The Tide and Mr. Clean ideas sprang from P&G's FutureWorks unit, which identifies and develops new businesses. Nathan Estruth, who runs the division, says his staff must get "comfortable with ambiguity" and accept that most projects "get shut down." P&G says not just any brand can be hitched to a service. It looks for a fragmented market where consumer expectations aren't high. (Don't expect Pampers Day Care centers.) Its research showed that both cleaners and car washes fit the bill.

P&G lacked franchising experience so it broke its decades-old practice of internal promotions and hired William Van Epps, who had managed franchising at **Pepsico**. P&G set up a company called Agile Pursuit Franchising with Van Epps in charge. His team put a premium on consumer convenience. Each dry cleaner features a double-lane drive-through and lockers accessible for after-hours pickup. There are lollipops for kids and Iams biscuits–yes, a P&G product–for the family dog. The company hopes to lure eco-conscious consumers with proprietary technology that doesn't use the solvent perchloroethylene. P&G says its stores will charge about the same to dry clean clothes as the industry average ($2.25 for a man's shirt; $11.50 for a dress).

Opening a Tide Dry Cleaners costs a franchisee about $950,000; a Mr. Clean Car Wash up to $5 million. Don Nix, a former accountant, operates a Mr. Clean Car Wash in Marietta, Ga., and plans to open a second one next year. People won't necessarily identify with "Don's Car Wash," he says. "The brand and the logo of Mr. Clean [has] huge value for attracting new customers."

While franchising allows P&G to offload much of the financial burden, the model is still risky. Corporate parents and owner-operators don't always agree. And dirty stores or lousy service could hurt Tide, which consulting firm Millward Brown ranks fifth globally as measured by value derived purely from brand equity. "If we did anything to damage that," says Chief Technology Officer Bruce Brown, "we'd stop." *—Lauren Coleman-Lochner, with Mark Clothier*

The bottom line *P&G is putting its Tide and Mr. Clean brands on dry cleaners and car washes. The risk is that franchising could tarnish their reputations.*



Tide Cleaners, like this one near Kansas City, stress convenience

Business Schools

Why B-Schools Have An Edifice Complex

▶ To attract students and donations, schools keep building

▶ "You can't be in a dump if everyone else is in a spectacular building"

The Yale School of Management crams students and faculty into 19th-century homes and former astronomy buildings linked by a rabbit warren of basements in New Haven. It's a far cry from the 40-acre Boston-riverfront campus housing Harvard Business School, which has a chapel, a health club, and its own art collection.

To catch up, Yale will erect a $180 million structure designed by Lord Norman Foster, the architect of London's "Gherkin" tower. "You can't be in a dump if everyone else is in a spectacular building," says Sharon M. Oster, the dean at Yale, which has begun preparing the construction site.

Elite business schools in the U.S. are locked in an arms race of sorts, constructing bigger and more elaborate campuses to attract applicants and professors and climb higher in magazine rankings, says Matthew Spiegel, a Yale professor of finance. New buildings mean more office space for faculty and

THIS PAGE: ED ZURGA/BLOOMBERG. OPPOSITE PAGE, CLOCKWISE FROM TOP LEFT: FOSTERS + PARTNERS/BLOOMBERG; ANDREW HARRER/BLOOMBERG; MELISSA LYTTLE/ST. PETERSBURG TIMES/ZUMA PRESS; MICROSOFT CORP./BLOOMBERG

more classrooms for profitable executive education programs. Larger schools can also enroll more students, who pay up to $80,000 annually in tuition and room and board.

While falling endowments at universities across the U.S. have forced construction cutbacks, business schools have been immune from the retrenchment, says Ronald G. Ehrenberg, an economist at Cornell University. "Graduates of business and law schools are often the wealthiest alumni," Ehrenberg says. "It is easy to raise the funds to build buildings from donors to those schools." To finance its new complex, for instance, Stanford Graduate School of Business secured $105 million, the largest gift in its history, from Philip Knight, the alumnus who heads athletic shoemaker **Nike**.



An artist's rendering of Yale's planned $180 million building

The building boom for top management schools was triggered in 2002, when the University of Pennsylvania's Wharton School dedicated its $140 million Jon M. Huntsman Hall in Philadelphia. The University of Chicago Booth School of Business began using its $125 million Charles M. Harper Center in 2004.

This year the Massachusetts Institute of Technology's Sloan School of Management will open new facilities in Cambridge. Stanford's B-school also will expand into a new building next year. Yale, Columbia University in New York, and Northwestern University in Evanston, Ill., are raising money for similar expansions.

It's a self-reinforcing pattern: Better buildings enhance student satisfaction, and that can spur future alumni giving, making management schools even richer and better able to build even more-impressive campuses, says Robert J. Dolan, dean of the University of Michigan's Stephen M. Ross School of Business. Michigan opened a new, $145 million building in January 2009.
—*Oliver Staley*

***The bottom line** Despite cutbacks in many college programs, top-tier graduate business schools are in the midst of a building boom.*

Briefs

by Cristina Lindblad

Burger King
New Owners for the Whopper?

Burger King Holdings is in talks with private equity firm 3G Capital Management about a buyout, according to a person familiar with the matter. The No. 2 U.S. hamburger chain has struggled to repair relations with franchisees and differentiate itself from archrival McDonald's. Sales fell 1.4 percent, to $2.5 billion, for the year ended June 30. TPG, Bain Capital, and Goldman Sachs Group bought Burger King from Diageo in 2002 and took the company public four years later. They still retain one third of the company.



JPMorgan Chase
Bank Shuts Proprietary Trading



JPMorgan Chase is closing its proprietary trading desk for commodities to comply with the so-called Volcker rule, which aims to curb risk-taking by banks. Next, the New York-based bank will close proprietary trading in fixed income, then equities, according to a person briefed on the matter.

Research in Motion
Corporate Loyalty is Fading

A survey by Sanford C. Bernstein shows that Research In Motion's BlackBerry is losing favor among companies. Of the 200 U.S. and U.K. companies polled, 74 percent now allow their employees to use rival devices. An August survey by Nielsen found that only 42 percent of BlackBerry users want to stick with the brand when they buy a new phone. The rate is 89 percent for iPhone users and 71 percent for Android devices.

Carrefour
The Retailer is Back in the Black

$104 MILLION

Carrefour, the world's No. 2 retailer, returned to profit in the first half of 2010, largely powered by cost cutting. Net income for the Paris-based company was $104 million, compared with a loss of $83 million a year earlier. Carrefour said it will accelerate discounts in the second half of 2010 to lure more French shoppers.

Interval Licensing
A Lawsuit a Decade in the Making



Interval Licensing, a defunct Internet research firm started in 1992 by billionaire Microsoft co-founder Paul Allen, has filed a patent infringement lawsuit against 11 companies, including Google, Apple, and Netflix. The suit claims that Interval developed now commonly used technologies for online shopping. Facebook and eBay have said they will fight the case.

Toyota
Japanese Sales of the Prius Sputter

Japanese sales of Toyota's Prius hybrid are set to plunge with the end of a Japanese government program that offers a $3,000 rebate to buyers trading in older cars for more fuel-efficient new models. Deliveries of the Prius more than tripled in the six months through June, to 20 percent of Toyota's total domestic sales.



On the Move
Changes in the Executive Suite

Ray Irani, the chief executive of Occidental Petroleum, is expected to announce plans to step down in 2011 at the next board meeting in October, *The Wall Street Journal* reported. Irani has come under fire from some investors over his oversized pay package. In other news, Digg, the Web service that lets people organize online news, hired Matt Williams, an 11-year Amazon.com veteran, as chief executive officer. News Corp. announced that former Hewlett-Packard CEO Mark Hurd will not serve as a director after Oct. 15.

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Politics&Policy



Business groups say Jackson lacks authority to selectively regulate carbon

PHOTOGRAPH BY PETER VAN AGTMAEL FOR BLOOMBERG BUSINESSWEEK

Lisa Jackson's High-Wire Act On Carbon Controls

▶ **The EPA chief is using her authority under the Clean Air Act to control carbon emissions**

▶ **New rules are "one of the greatest bureaucratic power grabs in the history of the U.S."**

Early in his Presidency, Barack Obama made it clear that if Congress failed to limit carbon emissions, he would use his authority under the Clean Air Act to control greenhouse gases. Now that Congress has pulled the plug on legislation, that task has fallen to Lisa Jackson, Obama's Environmental Protection Agency chief. Caught between business groups and some Senate Democrats who want to stop her, and environmental organizations that say she's not going far enough, Jackson may have the toughest job in town.

Even she agrees that regulation is inferior to legislation. It took a 2007 Supreme Court ruling to clarify that the 1970 law gave the agency the power to regulate carbon at all. One of Jackson's first moves as EPA administrator was to take up the court's invitation and declare carbon an environmental threat. Within weeks, she followed that with rules requiring automakers to boost fuel economy 5 percent a year and average 35.5 miles per gallon by 2016.

Those rules, effective Jan. 2, 2011, will mark the U.S.'s first-ever nationwide limits on greenhouse gas pollution. Now, having taken that step, Jackson by law must clamp down on other carbon sources. In an economic downturn, she hopes to avoid writing detailed diktats for small businesses, schools, hospitals, and apartment buildings—many of which emit enough carbon that broad-based rules could force them to install expensive equipment. That could be politically explosive in a midterm election year, letting Republicans charge that Obama is strangling the economy.

Instead, Jackson has moved cautiously by offering what she calls a "tailored" approach that exempts mom-and-pop dry cleaners and pizza parlors and initially regulates only power plants and oil refineries. And among those, only new or expanding plants need comply.

Even so, business groups, led by the U.S. Chamber of Commerce, are taking Jackson to court, saying she has no authority to regulate greenhouse gases under the Clean Air Act. Keith McCoy, vice-president for energy and resources policy at the National Association of Manufacturers, calls the greenhouse gas rules "one of the great-

est bureaucratic power grabs in the history of the U.S."

Some industry groups are making an unusual argument: that Jackson's not going far enough. It's all or nothing, they say, knowing that all-out regulation would be untenable. If the EPA wishes to regulate carbon, "then it ought to have to regulate facilities large and small and suffer all the consequences, warts and all," says Scott Segal, a Washington lawyer at Bracewell & Giuliani who lobbies for coal-fired utilities **Southern Co.** and **Duke Energy,** among others.

Segal and other lobbyists are on guard for Jackson's next move this fall, when the EPA will issue guidance to refiners and power plants on the "best available control technology" to limit the largest amount of emissions, taking into account cost and availability. If the guidance is severe, says Segal, it could delay new construction and expansion by manufacturers–and harm job creation.

Some Democrats from coal-producing states want to stop or postpone the EPA's efforts. Senator Jay Rockefeller (D-W. Va.) has readied a measure that would delay any rule for two years. To succeed, he would need 18 other Democrats to join 41 Republicans–not impossible, considering that half the states mine coal or burn it for most of their electricity.

An environmental group, the Center for Biological Diversity, sued the agency in early August, claiming the tailored regulations leave out too many large polluters. Texas Governor Rick Perry, meanwhile, has filed a lawsuit against the EPA for singling out refineries and power plants. "It's a knife's edge the EPA is walking right now," says Robert Stavins, director of Harvard University's Environmental Economics Program. He calls the EPA approach "inappropriate and unfortunate" if it ends up playing "into the hands of the Far Right and others who don't want any action on climate change."

The agency's first black administrator, Jackson, 48, stresses that the EPA is moving forward with "modest" steps to cut carbon that will add up over time. When she oversaw environmental policy from 2006 to 2008 under then-Democratic New Jersey Governor Jon Corzine, she was similarly criticized by business groups for policies they found too aggressive, and by environmentalists who didn't think she was aggressive enough. "She found a good balance," Corzine says.

Even Senator James Inhofe (R-Okla.), a leading skeptic of man-made global warming, likes Jackson's style. "She's established her integrity and openness to Democrats and Republicans," says Inhofe, the senior Republican on the Environment & Public Works Committee. He was so impressed after meeting her that he gave her a holiday card of his family, which now sits, framed, on her office shelf. "I'm a firm believer in the value of talking to people, of working together no matter what the politics," says Jackson, a chemical engineer by training who grew up in New Orleans' Ninth Ward.

Former House Energy & Commerce Committee Chairman John Dingell (D-Mich.) has warned that attempts to use existing law to regulate carbon will create a "glorious mess." So far, he seems to be right. Still, Jackson is forging ahead. "There is only so much this agency can do under the Clean Air Act," she concedes. "You can get started, and we need to get started." *—Kim Chipman*

The bottom line *The EPA's Jackson is caught between powerful forces as she tries to assert her limited authority to cut carbon emissions.*

750

BILLION DOLLARS

The Iraq War's cost after more than seven years of combat, which President Obama ended on Aug. 31.

DATA: NATIONAL PRIORITIES PROJECT

Midterm Elections

The Stimulus Vote Has Feingold on the Run



- **His possible Senate opponent says high-speed rail is a waste of money**
- **"Wisconsin taxpayers will be on the hook...for a costly train few will ride"**

You know Democrats are in danger of losing control of Congress when Russell Feingold is fighting for survival.

Wisconsin voters have chosen Democrats in the last six Presidential contests, including Barack Obama by 14 percentage points in 2008, and has elected only Democratic U.S. senators since 1992. Yet the nonpartisan Cook Political Report in August called Feingold's Senate race a toss-up, one of 13 too-close-to-call Senate contests. One reason he's struggling: His support last year for the economic-stimulus package that the Congressional Budget Office now says will cost $814 billion.

The White House claims the stimulus measure has created or saved some 63,000 Wisconsin jobs, in part by funding an $810 million high-speed rail line linking Milwaukee and Madison, Wisconsin's two largest cities. The rail proposal, one of 13 awarded a total of $8 billion in stimulus grants this year, is among the initiatives pushed by Obama that Feingold (above, right) is having to defend.

7.8%

Wisconsin's July unemployment rate

Democrats view high-speed rail as the next-generation interstate highway system. Ron Johnson, 55, a plastics executive who is Fein-

CLOCKWISE FROM TOP: TONY ALVEAR/BLOOMBERG; RICHARD POHLE/THE TIMES; TOM WILLIAMS/ROLL CALL/GETTY IMAGES

Jobs eyes the living room page 30 ►



gold's likely opponent on Nov. 2, calls it a waste of taxpayer money. Johnson, who is seeking office for the first time and still must face a Sept. 14 primary, would instead shore up existing infrastructure. "Wisconsin taxpayers will be on the hook for about $10 million per year for a costly train that few will ride," he says.

In an Aug. 17 interview amid campaign visits that included a dimly lit tavern and a tattoo parlor in South Milwaukee, Feingold said he'd "had tough races before." With the economy the way it is, "people are going to scrutinize" the contest, he said. Unemployment, at 7.8 percent, is lower than the July national average of 9.5 percent, yet the state has pockets of economic stress, such as in the south, where a **General Motors** assembly plant closed in 2008.

Feingold presents Johnson as outside the mainstream because he has ties to the Tea Party. Johnson says the relationship is minimal, though he welcomes its support. "The people I see at those rallies are good, honest, hard-working, taxpaying, patriotic Americans that absolutely share my concern for the direction of this country," he says.

Along with Senator John McCain of Arizona, Feingold is considered a father of campaign finance reform. Through June 30, he had raised $12.6 million, compared with $2 million for Johnson, who says he's ready to match Feingold's money out of his own pocket. "I'm all in on this thing, and I'm committed to get our message out," he says.

Johnson is a managing partner of Oshkosh-based **Pacur**, which sells medical and pharmaceutical packaging and other plastic products. He lists his personal worth between $10 million and $38 million on a financial disclosure report.

A Rasmussen Reports survey showed the two in a statistical tie as of Aug. 24. Lately, Feingold has benefited from Johnson's missteps. The Republican told the *Milwaukee Journal Sentinel* that "sunspot activity" is more likely the cause of global warming than carbon dioxide. In an interview, Johnson said he should've been more precise. "The point I was making," he said, "is I do not believe man-made global warming is settled science by any means."

Johnson is also attacking Feingold for his support of Obama's health-care overhaul, which Johnson says he would vote to repeal. But it's the rail line that is drawing voter attention. U.S. Transportation Secretary Ray LaHood, in a July appearance in Wisconsin, said: "There's no stopping it." Unless Republicans hold enough power next year to halt the line in its tracks. —*John McCormick*

The bottom line *Wisconsin Democratic Senator Feingold is in a tough fight because of his support for Obama's initiatives, including a high-speed rail line.*

British Politics

Tony Blair, Surprise Tory, Defends His Reign

- ► **The ex-Labour leader sounds a conservative note in his memoir**
- ► **"Government failed. Regulations failed. Politicians failed."**

Tony Blair, deficit hawk? That's the most interesting news to come out of the former British Prime Minister's just-published memoir, *A Journey* (Knopf, $35). The 700-plus-page doorstop of a book combines a defense of the Iraq War with a psychoanalysis of Gordon Brown—Blair's Labour colleague, rival, and successor—choice tidbits about the Queen, a modest appreciation of George W. Bush, and even a riff on the writer's drinking habits.

The most startling section deals with Blair's rejection of "the whole package of massive Keynesian deficit spending," as he writes in the book. "If governments don't tackle deficits, the bill is footed by taxpayers, who fear that big deficits mean big taxes, both of which reduce confidence, investment, and purchasing power." Sounds like a line from the office of Conservative Prime Minister David Cameron. The current Tory PM, who has startled the world with his vows to shrink government spending massively, is doubtless pleased to get support for his plans from a three-time election winner: His aides put choice sentences from Blair's memoir on Twitter throughout the day of publication.

Blair, now a millionaire and an adviser to **JPMorgan Chase**, also comes out against taxes on the rich and defends the big banks in the wake of the credit crunch that battered Britain. "Government also failed," he writes of the crisis. "Regulations failed. Politicians failed. Monetary policy failed."

These lapses happened on Gordon Brown's watch after he had succeeded Blair at 10 Downing Street. Blair's relationship with Brown was one of the most tortured in modern British politics, and the book uses soap-operatic language to describe it. "Like lovers desperate to get to love-making" Blair writes about himself and Gordon Brown early in their intertwined careers.



Blair and Cameron in 2009 at a World War I remembrance ceremony

Politics&Policy



The book defends George W. Bush and criticizes Gordon Brown

Brown was, in turn, mentor, closest political friend, and bitterest enemy. Blair makes it clear he now thinks that handing the reins of power to Brown was a mistake. "I had a feeling that my going and being succeeded by Gordon was also terminal for the government," Blair writes. "I discovered there was a lacuna –not the wrong instinct, but no instinct at the human, gut level. Political calculation, yes. Political feelings, no. Analytical intelligence, absolutely. Emotional intelligence, zero. Gordon is a strange guy."

There are other guy relationships. "We were political soul-mates," Blair says of himself and Bill Clinton. "He was a great guy, and good president, and above all he was a friend." Then there was the man from Texas. Before its publication, the book was described by British tabloid *News of the World* as "a love letter to George W. Bush." That's not really fair, though Blair does go gently on his U.S. ally. "George had a great sense of humour," he writes of the second President Bush, adding that W. "was self-effacing and self-deprecatory in an attractive way. He was very smart." The closest he gets to criticism is in a discussion of foreign policy: "George had immense simplicity on how he saw the world. Right or wrong, it led to decisive leadership."

For a political memoir, the book is a surprisingly good read. Granted, it contains more purple prose than the British are used to from their Prime Ministers. Take, for example, this passage dealing with his wife: "That night I needed that love Cherie gave me.... I devoured it to give me strength, I was an animal following my instinct."

Yet Blair could always tell a joke. He recounts how he stood next to the British monarch at a ceremony, which featured acrobats performing without a safety net, to celebrate the start of the millennium. Blair says that during the show he was chiefly concerned that the next day's headline would be "Queen Killed by Trapeze Artist at Dome: Blair Admits Not All Has Gone to Plan."

What is lacking is the confession and apology for misdeeds sought by his domestic opponents, many of them, it seems these days, in his own party. More than 100 pages are devoted to Blair's decision to join the war against Iraq. The former Prime Minister has the good grace to acknowledge that his explanation won't change many minds. —*Robert Hutton*

The bottom line *Blair's memoir has a strongly conservative tone, especially about deficits and taxes.*

Drawing Board





President Obama after signing the financial reform bill on July 21

Financial Regulation

The New Research Office: CIA of Finance?

- It will have broad powers to extract information from companies
- "This gets to the essence of what really causes problems"

Don't expect an Elizabeth Warren-style campaign for the first director of the Office of Financial Research, yet another agency set up under the financial system overhaul. Unlike the pending decision over who will lead the Consumer Financial Protection Bureau, which has prompted online petitions and a viral rap video in support of the Harvard law professor, the competition over who will be the head of the research office is a wonks-only affair. Two early contenders, Allan Mendelowitz, a former regulator of the Federal Home Loan Banks, and Lewis Alexander, a counselor to Treasury Secretary Timothy Geithner, are relative unknowns outside a small community of economists, statisticians, and risk assessment officers.

That may not last long. The research office is only now beginning to attract attention for the unusually strong powers Congress granted it to force financial companies to turn over confidential information and help spot potential market blowups. In a nod to its abilities to peer into the uncharted depths of the financial system, lobbyists are calling it the CIA of financial regulators.

CLOCKWISE FROM TOP: LARRY DOWLING/REUTERS; ILLUSTRATIONS BY MATT OWENS; ILLUSTRATION BY MATSON/ST. LOUIS POST-DISPATCH/CAGLE CARTOONS



The analogy may not be far off. Housed within the Treasury, the office will have both data collection and analysis arms. The law says it can demand "all data necessary" from financial companies, including banks, hedge funds, private equity firms, and brokerages. That would include previously secret details such as who the counterparties are for credit default swaps and information on individual loans such as interest rate and maturity. If companies aren't forthcoming, the director of the office can issue subpoenas. Providing the staff support to the new Financial Stability Oversight Council–and holding a nonvoting seat on the council, which will monitor the banking system for risks–the research office can require companies to submit "periodic reports" to help it determine which firms to keep tabs on.

Pushed by a committee of academics and current and former financial executives, including Nobel laureate Harry Markowitz, one of the founders of modern portfolio theory, the office was championed on Capitol Hill by Senator Jack Reed (D-R.I.). Among its first duties: Telling financial companies how their data must conform, so they can be more easily compared.

The office is insulated from politics, with its director appointed by the President and confirmed by the Senate for a six-year term. Congress also required the director to make annual reports to congressional banking committees, testimony that cannot be reviewed by other government or agency officials. After a two-year startup period during which the Federal Reserve will provide its budget, the research office's funds will come from fees assessed on large financial companies.

Proponents say the office's central mission is to help spot the next financial crisis as it is forming. "This gets to the essence of what really causes problems," says Clifford Rossi, a former chief risk officer at Citigroup now with the University of Maryland's Center for Financial Policy. "No single agency was really looking holistically across the entire system, going 'holy smokes, we've got a bubble of monumental proportions here.'"

Financial companies aren't so sure. They've raised concerns about the costs of complying with additional requests from a regulator. They also say they are worried about the disclosure of proprietary information. (While the law says confidential information needs to be protected, it also calls for the office to make its data available to the public. The office is also subject to the Freedom of Information Act.)

Moreover, bankers say, with the Fed and other regulators constantly requesting information and monitoring the markets, the research office is likely to be duplicative. "This idea that somehow these guys will notice the economic trends that everybody else is missing, I think that requires a certain suspension of disbelief," says Wayne Abernathy, an executive vice-president at the American Bankers Assn. B
—*Robert Schmidt*

The bottom line *Wall Street is worried about how a new research office to be set up within Treasury will use its broad powers.*

The financial overhaul law has hidden gems or new regulatory headaches, depending on your vantage point. Here are some overlooked sections:

Conflict Minerals
Computer, cell-phone, and other device makers must disclose what they are doing to avoid using tin, tungsten, gold, and other "conflict minerals" from the Democratic Republic of Congo.

Deposit Insurance
The temporary increase during the financial crisis in the maximum amount protected by the Federal Deposit Insurance Corp.—to $250,000 from $100,000 per account—is now permanent.

Free Credit Scores
While consumers already can obtain a free copy of their credit report, that doesn't include the actual credit score. Lenders who deny loans must give customers a copy of their credit-score report.

Publish What You Pay
Oil and mining companies must disclose all legal payments—taxes, royalties, fees—to any government.

Aiding & Abetting
The SEC gets a powerful new tool allowing it to charge lawyers, accountants, and other professionals who knew about a deceptive act, even if they weren't the wrongdoer.

Federal Insurance Office
Treasury will set up an office to monitor and modernize state regulation of insurance. The office will help identify systemically risky insurers.

Mine Safety
Mine operators must disclose to the SEC violations of health or safety standards and name any mine that has had a pattern of violations.

Short Sales
Institutions must disclose amount of short selling in each stock. Brokers must notify investors they can stop their shares from being borrowed for a short sale.

Bloomberg Businessweek
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Approved riding area.

"IF IT WAS SIMPLY ABOUT MONEY,

EVERY BANK LOAN WOULD BE A GUARANTEE OF SUCCESS.

At GE Capital, loaning money is the start of the relationship. Not the end. We provide exclusive financing for 1,400 independent Polaris dealers across the country. Providing financing means providing life to these dealers. But it has to be about more than money. We're out there helping Polaris identify new markets, go deeper into existing ones. I've been working with Polaris for 26 years. It's pretty simple math – GE Capital succeeds only if Polaris succeeds. Course, it also helps that I love to ride!"

GE Capital is invested in Polaris.



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Technology

Intel Wants to Be Inside Everything



▶ The company bets on a new kind of chip to break its PC reliance

▶ "There's a limit to where their core business will take them"

Two years ago, **Intel** held a contest for college students, asking them to come up with new uses for the company's Atom processor. One proposal: a shower that regulates water temperature and plays music from the Internet. While Intel doesn't plan to enter the shower market, it is putting its chips into gas pumps, cars, musical instruments, and other devices where few processors have gone before.

Chips that act as the brains of electronic devices other than computers or mobile phones are known as embedded processors and represent a $10 billion market, according to Intel Chief Executive Paul Otellini. That's small compared with the $34.5 billion market for PC processors. Intel will have $43 billion in revenues this year, according to analysts in a Bloomberg survey. Of that, only about $1 billion comes from embedded products, says the company. Still, Atom sales are growing fast, and the company is counting on the chip to help break its dependence on the slowing PC market. "There's a limit to where their core business will take them," says Alex Vallecillo, a fund manager at PNC Capital Advisors.

Although Atom chips aren't as powerful as the ones that run PCs, they're much cheaper, which makes them economical for powering all kinds of devices. **Nautilus** puts Atom chips into its treadmills to stream Internet video onto built-in displays and upload the times and distances from workouts, Intel Vice-President Doug Davis says. Digital advertising signage is another growth market for Intel, says Alex Gauna, an analyst at JMP Securities in San Francisco. **LG Electronics** is using Atom chips in signs that will recognize the age, gender, and other characteristics of passersby and change the advertising pitch accordingly–similar to electronic billboards in the 2002 Steven Spielberg science fiction film *Minority Report*. Since Atoms also use little power and don't require bulky batteries to run, they're popping up in unexpected parts of the world. In India, banks are using them in handheld terminals that serve rural areas off the electricity grid. Once a month or so, an itinerant teller visits a village, giving locals access to loans and other banking services.

LG Electronics is using Atom chips in signs that will recognize age, gender, and other traits of passersby

ARM Holdings sells designs for similarly energy-efficient chips that are licensed by customers including **Texas Instruments**, **Qualcomm**, and **Marvell**. Those companies already have a hold on the mobile-phone market–one area Intel has failed to penetrate–and are trying to expand that dominance into the embedded market. For now there's enough room for both Intel and ARM technology, according to JMP's Gauna. "It's a rising tide," he says.

In the second quarter, Intel received 3,800 inquiries from customers that wanted to design Atom into their products, says Davis. Some 1,200 of those proposals are on their way to becoming Atom-based products. While Intel isn't designing a different chip for each customer, it is offering so-called systems-on-a-chip, semiconductors with the functionality of multiple chips built into one. That makes it easier for electronics manufacturers to get their products to market quickly.

Intel also designs software that makes it simpler for customers to make products that use Atom processors. Last year, the company paid $884 million to acquire **Wind River Systems**, ➡

ILLUSTRATION BY HARRY CAMPBELL



which designs operating systems for cars, mobile phones, and industrial machinery. Wind River tailors commonly used operating systems such as Linux and **Google**'s Android to work on Intel's chips. Operating systems are the basic set of programs that control any device with a chip. If Wind River didn't customize that software, the manufacturers would have to do so themselves at considerable effort and expense.

In its largest acquisition ever, Intel in mid-August purchased security software maker **McAfee** for $7.68 billion. The company's rationale: With all these Atom-powered gizmos connected to the Internet, they're going to come under the same kind of virus and malware attacks that plague PCs. That will require protection, which works better if the software is built into the chips. —*Ian King*

The bottom line *Embedded processors are a fast-growing business for Intel that may help it reduce dependence on the maturing PC market.*

Media

Don't Rule Out Apple Ruling Your Living Room

- The new Apple TV fits into Steve Jobs' entertainment vision
- "TV is too important for Apple to ignore"

Apple's decade-long run of iPod-, iPhone-, and iPad-fueled prosperity has featured only one notable dud. Introduced in 2006, Apple TV is a set-top box used to play movies and other digital fare on a TV via iTunes on a Mac or PC. Apple has sold fewer than 3 million of them, estimates Kaufman Bros. analyst Shaw Wu. The company sold that many iPads in three months.

And yet, at a Sept. 1 event in San Francisco, Steve Jobs announced that Apple is bringing out a less-than-revolutionary upgrade. The new Apple TV looks different–it's black, not white, and at 3.9 inches square, is 75 percent smaller than the old one–and you now rent rather than buy movies and TV shows. (The price has also fallen, from $229 to $99.) Otherwise, its function is mostly unchanged. "You're still looking at a product for the Apple fanatics," says technology marketing consultant David Clarke of BGT Partners.

So why bother? Even Jobs concedes the device is mainly for tech hobbyists, and most of the Sept. 1 event was dedicated to the revelation of a new line of iPods and a social networking feature that works within iTunes. What Jobs didn't say is that Apple wants to become king of the living room. He tells *Bloomberg Businessweek* that when the time is right, Apple could open an App Store for the TV that could do for television sets what all those apps have done for the iPhone. Asked if the iPad could evolve into the TV of tomorrow, Jobs shrugs and says, "That's how I do most of my TV watching today."

Still, the timing for such an evolution isn't upon us, Jobs says. Apple's biggest obstacle may be that it doesn't have the rights to sell shows the way it wants. Many studios, nervous about angering the cable companies that pay billions for their content, refused Apple's efforts late last year to put together a subscription service, say three media executives involved in the talks, who requested anonymity because they did not have approval to discuss the negotiations. Consumers would have been able to purchase only those shows they want in an a la carte model, rather than pay for hundreds of channels they never watch.

Apple gave up on that idea this past spring, say the executives. Rather than continue to fight a losing battle to replace the cable box, the company refocused on making it iPod-simple to watch shows across all of its devices. With a new software update coming in November, fans of the **Fox** show *Glee*, for example, will be able to rent an episode, start watching on their iPhones during the morning commute, watch



Jobs introduces the revamped Apple TV



Apple's $1 billion data center under construction in Maiden, N.C.

some more on the PC during lunch, and finish up after work with the iPad or Apple TV.

Rather than seek drastic pricing changes from studios, Apple pressed for the right to rent their TV shows for 99¢ per episode, say the executives involved in the discussions. Apple already was selling many movies for $9.99 and TV shows for $1.99 ($2.99 for high-def) on iTunes. The new thinking: A flat 99¢ price per episode–$4.99 for movies–might spark a change in TV watchers' behavior, just as it did in music a decade ago. Apple executives, led by Internet services Vice-President Eddy Cue, argued that it could mean billions in incremental sales for the studios as 120 million Apple device owners rent missed episodes to watch on the grocery line or airplane, says one of the executives.

Even that proved to be a difficult victory. Studio chiefs are getting hit with new TV schemes from every direction. **Netflix**, **Yahoo!**, and **Amazon.com** have deals with mobile handset makers, TV set manufacturers, and other hardware companies. **Google** is coming out with its own offering, which will initially run on **Sony** TVs and **Logitech** set-top boxes. In the end, only **News Corp.**'s 20th Century Fox unit and **Walt Disney**'s ABC have agreed to provide shows for Apple to rent. In News Corp.'s case, the agreement is for a trial period. (Jobs is Disney's largest shareholder and sits on the company's board.)

If Hollywood isn't ready to distribute TV as Jobs would like it, Apple is still well positioned to pull off an a la carte model in the future. All of its devices function easily together, tied by software that no other consumer technology company has been able to match for utility and style. "Today's announcements were just a stepping stone," says Michael Gartenberg, a partner at consulting firm Altimeter Group. "TV is too important for Apple to ignore." If Apple keeps growing the way it has, it may be too big for the media giants to ignore: Apple has 160 million credit-card numbers on file thanks to iTunes, while **Comcast** has 23 million.

A big question will be whether Apple opens an App Store for Apple TV. If it does that, and history repeats itself, thousands of developers might then race to create programs suited to the TV. Tim Westergren, chief executive officer of the streaming music service **Pandora**, is already dreaming of the possibilities for his business. "When I was a kid, I used to stare at album covers for hours," he says. "This could be a big, interactive album cover."

None of this will come cheap for Apple. The company is putting the finishing touches on a $1 billion, 500,000-square-foot data center set off a two-lane road in rural Maiden, N.C., population 3,200. If you stand by the cemetery behind Cedar Grove Baptist Church, you can get a pretty good look at the site through the trees. Code-named Project Dolphin by local officials, Apple's facility could be used for storing your iTunes music and video, or to take on **Facebook** in a bigger way. Apple isn't saying. Whatever the company is cooking up, it'll be big, says David J. Cappuccio, an analyst with Gartner: "Any company that is investing a billion dollars must have some serious plans." *—Peter Burrows, with Adam Satariano, Sarah Rabil, and Andy Fixmer*

The bottom line *The Apple TV update won't wow consumers, but it's a long-term bet on Apple's place in the living room.*

FROM TOP: NANCY PIERCE; PAUL SAKUMA/AP PHOTO

Mergers & Acquisitions

Tech Companies Go Shopping Abroad

▶ To avoid taxes, some companies are using their cash overseas

▶ Cisco plans to be "very aggressive outside the U.S."

U.S. technology companies are in a bind. Although they are cash-rich, much of their hoard is parked abroad and they risk a hefty tax bill if they bring profits from overseas back home. They have joined other U.S. businesses in lobbying for a tax holiday for repatriated earnings, but with no prospects of success in the near term, they're looking for something to do with that money. "We should see more tech cross-border acquisitions because of the cash trapped abroad," says Drew Guevara, who runs Morgan Stanley's West Coast technology investment banking group in Menlo Park, Calif.

A pickup in overseas mergers and acquisitions is already visible. The volume of cross-border tech deals involving a U.S. buyer has reached $7.6 billion so far this year, a 168 percent increase from the same period in 2009, according to Bloomberg data. In February, **Micron Technology** agreed to pay $1.3 billion for **Numonyx Holdings**, a

989.99

DOLLARS

Price of Samsung's 50-inch 3D plasma TV, $1,510 less than a comparable set from Panasonic. Samsung's move could spark a price war in the U.S.

DATA: BESTBUY.COM

Swiss maker of flash memory chips. Of **Google**'s 22 acquisitions this year, 7 have been abroad, including the purchase of Israel's **LabPixies** in April and Sweden's **Global IP Solutions** in May. And **Intel** announced on Aug. 30 that it was buying the wireless business of German chipmaker **Infineon Technologies** for $1.4 billion.

Speaking at a conference in Boston in June, **Cisco Systems** Chief Executive Officer John Chambers said he plans to be "very aggressive outside the U.S." if the tax rules don't change in the next year or so. Cisco has $30 billion of its $38 billion in cash parked abroad because of higher U.S. taxes, he said. It has spent $22.2 billion on 87 acquisitions in the last 10 years; 11 were outside the U.S. Its biggest overseas deal was its $3 billion purchase last of year of Norwegian videoconference equipment maker **Tandberg**.

"The U.S. system needs a long-term reform to compete with the rest of the world," says Dean Garfield, CEO of the Information Technology Industry Council, a Washington-based trade group. Tech companies have been so vocal on repatriation because many are cash-rich and relatively debt-free. That lets them scoop up a hot startup or invest heavily in a new gadget. The eight largest tech companies are sitting on $300 billion in cash, according to data compiled by Bloomberg. C. Fritz Foley, an associate professor of international financial management at Harvard Business School, notes that once Japan and the U.K. amend their tax codes later this year, the U.S. will be the only country in the Organization for Economic Cooperation and Development to double-tax foreign profits.

Finding attractive acquisition targets abroad can be difficult, say some bankers. **Autonomy**, Britain's No. 2 software company, which gets 70 percent of its sales from the Americas, might look attractive to **Oracle**, for instance. But with an enterprise value of $5.8 billion, or seven times sales, it would make a costly acquisition. "The interesting companies in growth markets are very expensive," says Storm Duncan, global head of technology M&A at Credit Suisse in San Francisco. —*Serena Saitto*

The bottom line *U.S. tax laws make cross-border takeovers attractive for American tech companies. Targets are not all that plentiful—or affordable.*



Weiner wants global revenues to rise from their current 20 percent

Social Networks

LinkedIn's Overseas Route to an IPO

- **The 76 million-user network aims to replicate its U.S. success abroad**
- **Until its new focus, "we weren't necessarily a global company"**

The road to a highly anticipated initial public offering for professional networking site **LinkedIn** may go through the United Kingdom, India, Australia, the Netherlands, and Canada.

The Mountain View (Calif.)-based company has always attracted users in these countries and elsewhere around the world. Of its 76 million members, who use the site to post résumés, hunt for jobs, and socialize with colleagues, more than half live outside the U.S. But LinkedIn, whose chairman, Reid Hoffman, has repeatedly talked about the likelihood of an eventual IPO, must prove it has a global business, not just a global user base. "My overseas contacts increasingly join LinkedIn to connect with me," says Josh Bernoff, an analyst at Forrester Research. "For LinkedIn to really capitalize on this sort of activity, they'll have to serve those international businesspeople in their own languages."

$228 MILLION

LinkedIn's 2010 revenues, estimated by Global Silicon Valley Partners

The company makes money primarily by selling ads and licensing its flagship product, LinkedIn Recruiter. That tool, which fetches a fee of about $7,000 per user, lets companies specify qualifications for a job they want to fill (bankers who speak Mandarin, for example) and receive lists of all the LinkedIn members who fit those parameters. Jeff Weiner, LinkedIn's chief executive, says international revenues account for slightly above 20 percent of LinkedIn's annual sales. Global Silicon Valley Partners, a financial planning and research firm, estimates 2010 revenues will reach $228 million and pegs LinkedIn's valuation at $1.87 billion. Internet companies such as **Google** and **Amazon.com** see more than half their revenues from abroad.

Now LinkedIn is trying to correct that imbalance and boost its overseas business. In the past eight months it has opened offices in Mumbai, Amster-



A ski resort stalls in Snowmass page 39 ►

dam, Dublin, and Toronto. It opened a London branch in early 2008. "We were the leading global professional network, but we weren't necessarily a global company, and those two things are different," says Weiner, who spent seven years at **Yahoo!** before becoming CEO of LinkedIn at the end of 2008.

Motivating LinkedIn's global expansion may be a dash of **Facebook** envy—and perhaps a little fear. Facebook has gradually moved into LinkedIn's territory, with its older users often posting professional details and connecting with colleagues on the site, though analysts don't necessarily believe the two networks overlap. "As Facebook currently exists, it's not a very good business network and therefore is not a threat to LinkedIn," says Forrester's Bernoff. Weiner also points out that people want to "keep their personal life and professional life separate."

LinkedIn, like **Twitter** and Facebook, now prominently features an activity feed—a constantly updating list of job changes, information requests, and other revisions on the LinkedIn pages of a user's contacts. Later this year, members will be able to tailor their feeds to track status updates and job changes from everyone in a specific company or industry. "We want to make sure people see the full value of LinkedIn," Weiner says. "If they are not using it every day, we want them to feel like they are not doing their job."

For the first few years after its founding in 2003, LinkedIn mostly tried to boost its global presence by developing versions of its site in foreign languages, including, most recently, Italian and Portuguese. That increased membership in those countries, but never did much for revenues.

LinkedIn executives say the first international office, in London, was a test case to see if employees on the ground could increase sales of ads and its LinkedIn Recruiter service. Since the London office opened, membership in Europe has jumped from 5 million to 16 million, and the company inked ad deals in the region with **Accenture**, **Philips**, and **Cisco Systems**' WebEx division.

Arvind Rajan, LinkedIn's vice-president of international, says the company has since exported its London blueprint to other countries where membership growth is strong. That has required navigating around a few local professional networks in nations such as France, where a site called **Viadeo** is entrenched, and Germany, home of **Xing.com**. But executives note that LinkedIn is growing faster than either of those companies in their home countries, partly because users want to connect with other professionals around the world.

Rajan says he recently spent a week in Brazil to scout opportunity for a local office. Japan, he says, is another possibility, though white-collar workers there tend to stick with one company, and openly looking for jobs may be considered bad manners. The other expansion possibility for LinkedIn is China. However, LinkedIn execs have watched the misadventures of Google, which repeatedly tangled with the Chinese government and moved its search operations to Hong Kong in March. "We don't take entrance into China lightly, and it's only becoming more complicated every day given what happened last year," Rajan says. —*Brad Stone*

***The bottom line** LinkedIn, which is expected to go public over the next year, first needs to show it has a worldwide business.*

Quoted

"They have to install servers in India. ... This applies to all."
—India Home Secretary G.K. Pillai, speaking of his government's effort to get Research In Motion, Google, and other service providers to allow securities agencies to monitor traffic



Internet

Looking for Holes in Beijing's Great Firewall



► AnchorFree's service lets Net users avoid censors in China

► "It's always going to be a cat-and-mouse game"

David Gorodyansky started **AnchorFree** in 2005 to help make Web surfing free and private in coffee shops, airports, and other places with wireless hotspots. He never predicted that five years later his company's biggest growth area would be people seeking ways to skirt government censors in China.

A growing number of China's 420 million Web users are turning to services that connect them to servers outside the country to gain access to sites blocked by China's extensive filtering software, known as the Great Firewall, says Ethan Zuckerman, a senior researcher at Harvard University's Berkman Center for Internet & Society. The proxy services, as these anti-censorship businesses are called, have become so common among China's educated class and Western expatriates that the fees they charge are sometimes referred to as an "Internet tax," Zuckerman says.

AnchorFree, based in Mountain View, Calif., runs a free, ad-supported proxy service called Hotspot Shield. Users download an application from AnchorFree's website that connects them to the Internet via a virtual private network, or VPN, similar to what telecommuters use to log onto an office network. Most computers connected to the Internet are assigned a unique number, or IP address, to route users quickly to the right destination. AnchorFree's software assigns an anonymous address that can be traced back only to the company and not to the user, according to Gorodyansky. "We send you on a virtual trip outside China," he says.

Lately there have been more reasons to circumvent China's Great Firewall. Access to several popular U.S. sites, including **Twitter** and **Microsoft**'s Bing, was limited in summer 2009. Authorities had stepped up censorship in advance of the 20th anniversary of the Tiananmen Square protests, Xiao Qiang, director of the Berkeley China Internet Project, told Bloomberg News at the time. The issue gained exposure at the start of this

FROM LEFT: ROBERT GALBRAITH/REUTERS; ADRIAN MYERS/CULTURA/AURORA PHOTOS; SHEKHAR YADAV/INDIA TODAY GROUP/GETTY IMAGES; ILLUSTRATION BY GRAHAM ROUMIEU

Technology

1.16 MILLION

Users of AnchorFree's Hotspot Shield in China

year, when Google said it would stop filtering its search results in China.

As China's censorship has become more sophisticated, AnchorFree's popularity has grown. The company saw users of Hotspot Shield rise 159 percent over the past year, to an average of 8.52 million each month during the second quarter, as users in China more than doubled to 1.16 million in the same period. The company has also seen growth in Iran, Turkey, Georgia, and the United Arab Emirates—all known to filter websites—as well as Canada, where people use it to gain access to U.S.-only video site **Hulu**.

Part of Hotspot Shield's appeal is that it's free. Ads appear to users as a banner inside a frame that surrounds the user's Web browser. The company works with **Yahoo! China** to sell ads. AnchorFree says such ads have made its business profitable; the closely held company does not disclose revenues.

Hotspot Shield may eventually become a victim of its own success: The more attention paid to a proxy service, the more reason China's censors have to shut it down. These services aren't explicitly banned in China, though the authorities block access to them from time to time. "It's always going to be a cat-and-mouse game," says Austin Heap, who last year co-founded the nonprofit Censorship Research Center in San Francisco.

AnchorFree's website, from which the Hotspot Shield application can be downloaded, has been blocked in the past by the Chinese government, the company says. When that happens, the company finds alternative ways to distribute the program, such as e-mail. Users who can't get access to AnchorFree's site to download the program can e-mail win@anchorfree.com or mac@anchorfree.com to get an automatic response with the program attached. "We anticipate technological conflicts," says Gorodyansky.

—Douglas MacMillan, with Vincent Ni

The bottom line *With censorship in China tightening, locals and expats are turning to "proxy services" that give people access to Western websites.*

Innovator

David Margolis



A North Carolina medical professor is leading a reinvigorated effort to find a cure for AIDS. His weapon: a rarely used cancer drug

As life goals go, David M. Margolis' is modest enough: He just wants to cure AIDS. The University of North Carolina professor has been plotting the demise of the world's deadliest infectious disease for more than a decade. Now he's planning a fresh assault with an unlikely weapon: a rarely used Merck cancer drug.

Margolis and his team plan to test the drug, Zolinza, in about 20 patients next year to see if it can flush out the stubborn reservoirs of HIV that existing treatments don't clear. Margolis doesn't expect Zolinza to cure AIDS, yet some success would confirm he's on the right track. "It's really all about trying to move the field ahead," says the New Haven native. "You don't know until you try."

Margolis, who followed his father into medicine, is at the forefront of a renewed quest to cure AIDS, spurred by the success of drugs that control the virus and the failure to find a vaccine to halt its spread.

Governments, companies, and foundations are sinking more money into research for a cure. Merck, Gilead Sciences, and Johnson & Johnson are looking for drugs to purge latent HIV, and in July the U.S. National Institutes of Health offered $8.5 million for research projects aimed at finding a cure. "It's gone from being a hopeless problem to one that people think we should devote a big effort to," says Robert F. Siliciano, a Johns Hopkins University professor who first identified the cells in which HIV hides out.

Drug cocktails are capable of reducing HIV to undetectable levels without eradicating it. The virus survives with the help of an enzyme called HDAC that effectively (and unhelpfully for the patient) lulls HIV to sleep in cells by interfering with its ability to replicate. When patients stop taking their pills, the latent virus roars back to life. In a laboratory test, Margolis found that Zolinza, which appears to work by blocking HDAC, could coax HIV out of hiding in cells taken from infected patients. Now he wants to see if he can achieve the same result inside the body: "We expect to show whether it can work the way we think it does in people."

The trial will be Margolis' second bid to root out latent HIV with an approved drug. His earlier study using Abbott Laboratories' bipolar disorder drug Depakote yielded promising results, which Margolis and others disproved. "He's an important thought leader in this field," says Romas Geleziunas, Gilead's head of biology.

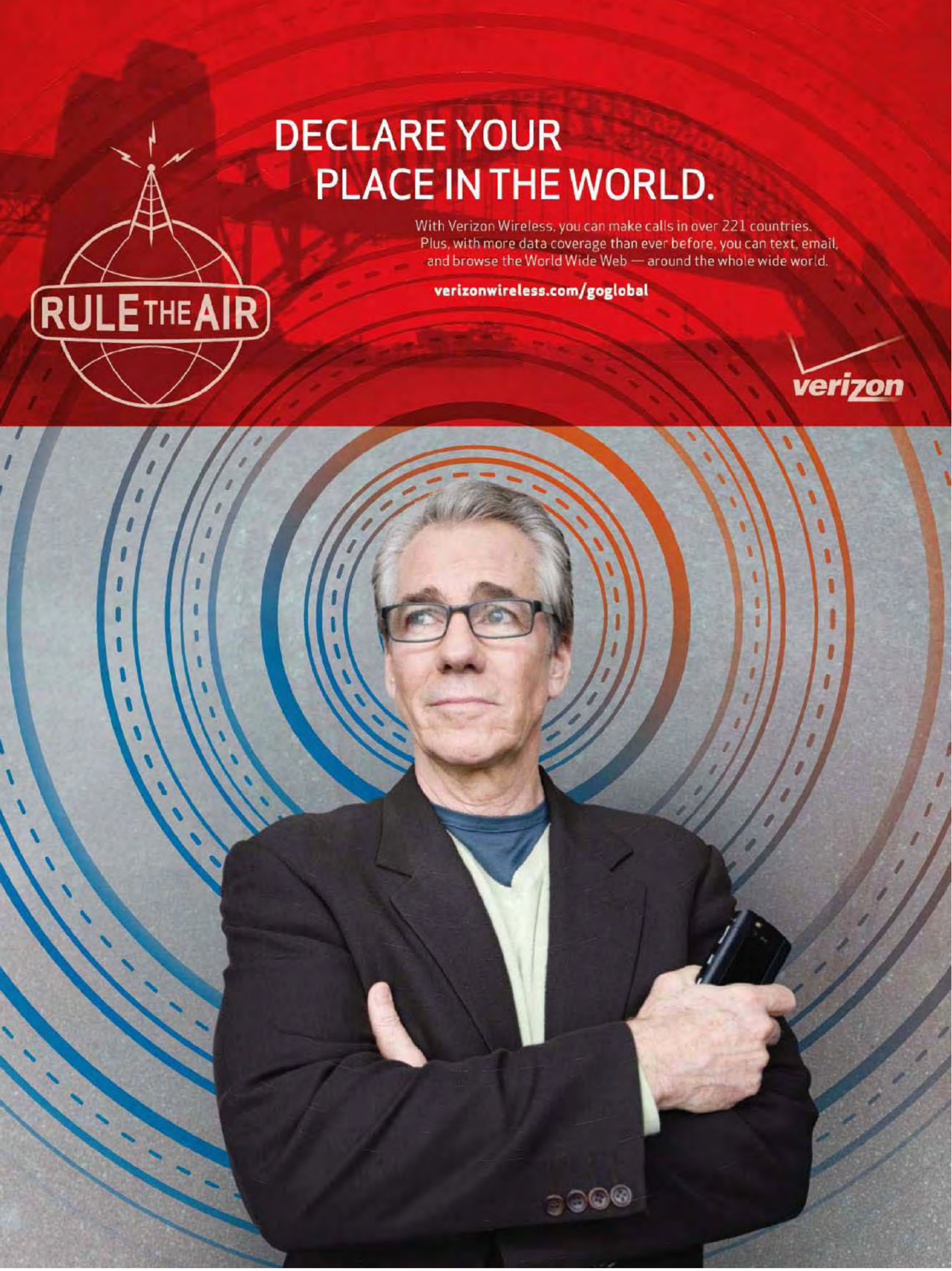
Some scientists doubt a cure will ever be achieved because of HIV's ability to integrate itself into a person's DNA. "We've never eradicated an integrated virus," says David Cooper, director of Australia's National Centre in HIV Epidemiology and Clinical Research. Margolis, who apart from his research also cares for some 100 patients, is more optimistic. "I'm 51," he says. "I wouldn't be doing this if I didn't think I had time to succeed." *—Simeon Bennett*

Training ▶ **Studied at Harvard and Tufts University School of Medicine**

Present ▶ **Ferreting out latent HIV using drugs already on the market**

Challenge ▶ **Seeking a cure for AIDS**

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Markets&Finance

In the Battle of the Big Brokers, Merrill is Winning



▶ Morgan Stanley has more advisers, but they bring in less profit

▶ The Smith Barney merger "is probably not going as well as they thought"

The financial crisis shook up the brokerage landscape. **Bank of America** acquired industry leader **Merrill Lynch** in 2009. That same year, **Morgan Stanley** jumped from fifth largest by client assets to first when it bought a controlling stake in a venture with **Citigroup**'s Smith Barney. Now, Merrill Lynch and Morgan Stanley Smith Barney are engaged in one of the more intense rivalries on Wall Street. To make things more interesting, former Smith Barney head Sallie Krawcheck is leading Merrill's charge, and former Merrill brokerage chief James P. Gorman is running Morgan Stanley.

Merrill Lynch has emerged with a clear edge: In the first half of this year it produced $315 million more profit from its brokerage than Morgan Stanley, according to company filings, and did so with 2,900 fewer financial advisers. Its pretax profit margin, 16.7 percent for the same period, is more than double Morgan Stanley's 7.8 percent.

Merrill's superior results stem from a smooth integration with Bank of America, analysts say, and being more effective at selling additional products to brokerage clients. "Merrill Lynch long ago led in banking, financial planning, insurance, and they are the more diversified firm," says Charles Roame, managing principal of Tiburon Strategic Advisors, a consulting firm in Tiburon, Calif. "It will win the banking-integration bet. Morgan Stanley will not catch them."

The job of catching up falls to Gorman, 52. An Australian, he joined Merrill Lynch in 1999 from consulting firm McKinsey and was named to lead a restructuring of Merrill's famed "thundering herd" in 2001. He cut the number of brokers by one-third over two years, closed a quarter of the firm's retail branches, and shifted its focus to the wealthiest clients before leaving the company in 2005. His track record gives investors and brokers confidence that he will improve Morgan Stanley Smith Barney's performance, analysts and industry executives say, as he competes with a company still benefiting from the strategy he devised.

Merrill is still benefiting from a strategy devised by James Gorman, the man now running its rival

Gorman, who joined Morgan Stanley in 2006 and became chief executive in January, declined to comment. A Morgan spokesman, Jim Wiggins, says the firm likes its position. "There are great synergies with our institutional businesses, and we have a clear, multiyear plan to grow the profit margin," he says. ➜

ILLUSTRATION BY OLIVER MUNDAY

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Letters to the Editor can be sent by e-mail, fax, or regular mail. They should include address, phone number(s), and e-mail address if available. Connections with the subject of the letter should be disclosed, and we reserve the right to edit for sense, style, and space.

Gorman's chief rival is Krawcheck, 45, who oversees Merrill Lynch as president of Bank of America's wealth unit. Krawcheck, who grew up in Charleston, S.C., is going head to head with Smith Barney, which she led from 2002 to 2004 and in 2008 when she worked for Citigroup. "We've got the leadership position, but we can't rest," Krawcheck said in an e-mail. "Staying focused on the clients, meeting the needs and demands that have come out of the downturn, and leveraging the competitive advantages of Bank of America will keep us ahead."

Based in New York, Krawcheck has long been one of the most prominent women on Wall Street. She has kept a low profile at Bank of America, says Mindy Diamond, president of Diamond Consultants, a Chester (N.J.) executive search firm for the brokerage industry. "We talk to zillions of Merrill advisers all the time, and her name never comes up," Diamond says. "It's very different at Morgan Stanley, where Gorman absolutely has a rock-star advantage. Many advisers are staying there because they respect him so much."

The firms manage about the same amount of client assets—$1.4 trillion at Merrill, compared with $1.5 trillion at Morgan Stanley—and have comparable revenue: $6.4 billion in the first half at Merrill and $6.2 billion at its competitor. Yet Merrill earned $675 million from its brokerage in the first half, while Morgan Stanley Smith Barney made $360 million. On average, each of Merrill's 15,142 brokers brought in $836,000 on an annualized basis compared with $682,000 for Morgan Stanley's 18,087.

The large size of Merrill Lynch compared with Bank of America's brokerage unit made combining forces easier than at Morgan Stanley, which had to integrate two similarly sized operations with a lot of overlap, says Guy Manuel, founding partner of CBM Group, a New York consulting firm. Merrill Lynch had 16,000 brokers in September 2008 when its sale was announced. Charlotte (N.C.)-based Bank of America had about 2,000.

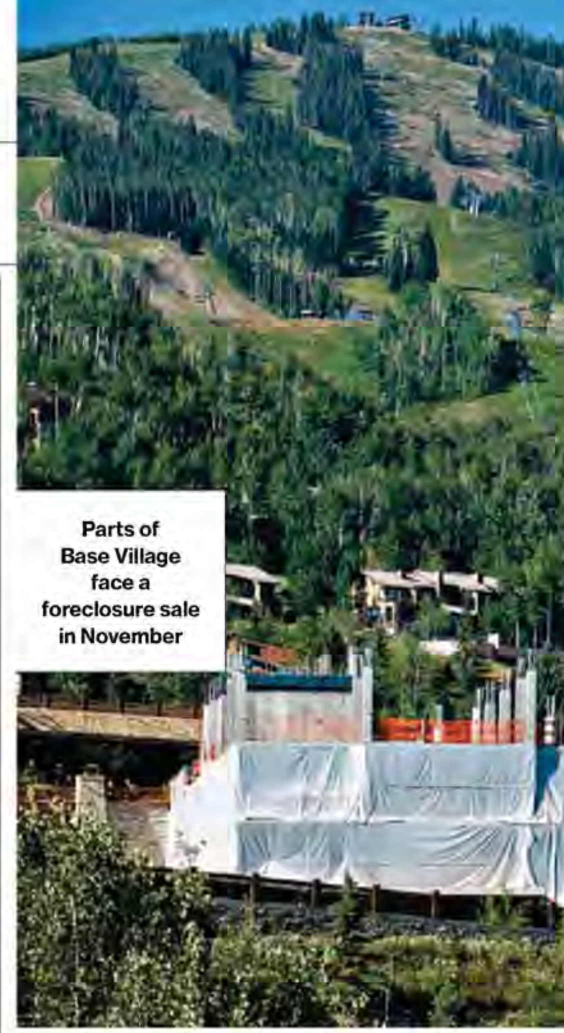
Morgan Stanley's absorption of Smith Barney "is probably not going as well as they originally thought," says Douglas Sipkin, a New York-based analyst at Ticonderoga Securities. Gorman said in February that the brokerage would have $450 million in integration costs this year, after $280 million in 2009. He said he expects a minimum of $1.1 billion in cost savings at the unit by 2011.

Merrill Lynch also has a lead in cross-selling. It has 800 bankers assigned to persuade brokerage clients to take out a mortgage from or move money to Bank of America, the largest U.S. lender by assets, resulting in 80,000 sales of banking products in the second quarter compared with 35,000 in all of 2009, according to a regulatory filing. "There's more of a natural referral flow at Bank of America and Merrill Lynch," says Douglas G. Ciocca, managing director at Renaissance Financial in Leawood, Kan., which manages $2 billion.

To close the cross-selling gap, Morgan Stanley hired 100 bankers to offer loans and deposit products to brokerage clients. The unit may quintuple its ranks by the end of 2011, a person with knowledge of the strategy says.

There may be more at stake in the broker battle for Morgan Stanley, which got 36 percent of first-half net revenue from wealth management, than for Bank of America, which relied on the Merrill Lynch brokerage for 10 percent of net revenue. Yet neither company can afford to slip. **Wells Fargo**, the third-largest full-service U.S. brokerage and a leader in cross-selling, has almost as many brokers as Merrill and oversees $1.2 trillion in client assets.

Merrill, Morgan Stanley, and Smith Barney controlled 25 percent of the industry assets under management in 2009, down from 32 percent in 2007, figures compiled by Cerulli Associates show. Independent advisers and regional broker-dealers have increased their percentage of assets to 32 percent



Parts of Base Village face a foreclosure sale in November

from 28 percent in 2007. "Competing in this world is much different than it was in the 1980s and the 1990s," says Anthony DeChellis, head of **Credit Suisse Group**'s private banking Americas business. "Clients are getting better at choosing the firms where they can get the best advice and the best guidance."
—*Michael J. Moore and David Mildenberg*

The bottom line *Merrill Lynch earns higher profits with fewer advisers, thanks to a smooth integration with Bank of America and more cross-selling.*

Quoted

"There's an awful lot of positive stuff here in our numbers today. ... It generally takes four or five years to stabilize the whole [housing] market. We're into about four now."
—Karl Case, co-creator of the S&P/Case-Shiller home-price index



Asia

Citigroup Bets on More Growth in China

- **The bank will triple its workforce and open 10 new branches**
- **"We have aggressive consumer-banking expansion plans"**

Citigroup Chief Executive Officer Vikram Pandit is raising his bet on China, where banks extended a record $1.4 trillion of new loans last year. Citigroup plans to nearly triple its workforce in the country, to as many as 12,000 in the next three years, intensifying its rivalry with London-based **HSBC Holdings** in the world's fastest-growing major economy.

FROM LEFT: WELLESLEY COLLEGE; EDDIE KOSMICKI/BLOOMBERG



The New York-based bank will hire more people in China than in any other Asia-Pacific country, says Stephen Bird, Citigroup's co-CEO for the region. The expansion may make China Citigroup's third-largest market by staff, after the U.S. and Mexico, says spokesman James Griffiths. "This is a strong message from Citigroup that signals the bank's focus and dedication to the country," says Michael Werner, an analyst at Sanford C. Bernstein in Hong Kong.

Citigroup has 29 branches in the country and plans to add 10 more this year. That will still leave it short of HSBC's 102 and the 59 operated by London-based **Standard Chartered**, which gets more than three-quarters of its profit from Asia. "China is one of Citi's priority markets globally," says Bird. "We have aggressive consumer-banking expansion plans and want to open branches as fast as regulators in China will let us."

Bird says consumer and institutional banking will account for about 80 percent of new hiring in China. The remainder will mainly be for technology support and data processing. Citigroup has 4,500 employees in China and 50,000 in Asia, according to Griffiths. Standard Chartered has more than 4,000 employees at its China unit; HSBC, Europe's largest lender by market value, has more than 5,000. **Industrial and Commercial Bank of China**, the world's largest lender by market value, had 390,000 workers at the end of 2009.

China, which opened its banking industry to overseas companies in December 2006, is attracting foreign lenders scarred by the global financial crisis that forced Citigroup into a $45 billion U.S. government bailout. HSBC is focusing on emerging markets such as China following losses at its U.S. unit.

Asia was the largest regional contributor to Citigroup's earnings in 2008 and 2009, a period during which it lost a total of $29.3 billion worldwide. This year, Citigroup recorded a first-half profit of $2.5 billion in the region on revenue of $7.26 billion. Deposits in Asia rose 20 percent in June from a year earlier, to a record $220 billion, Griffiths says. The bank offers mobile banking in most of the 18 markets in the region it serves and started retail banking in Vietnam in the past year.

Citigroup is also expanding in Taiwan and Hong Kong, where it has 66 and 41 branches, respectively, Bird says. "Just a couple of years ago we were under 50 branches in Greater China, and in the next six months we should hit the 150 mark." —*Cathy Chan*

The bottom line *Going where the growth is, Citigroup is investing heavily to expand its presence in the rapidly expanding Chinese market.*

Failed Banks

A German Lender Stumbles in Snowmass

▶ A luxury development in Colorado sits unfinished as lawsuits play out

▶ "Their megalomania was what brought them down in the end"

Snowmass Village, the Colorado ski town, got a lift in 2007 when Germany's Hypo Real Estate Holding agreed to arrange $520 million in loans to complete a $1 billion year-round resort called Base Village at Snowmass. The development planned to offer luxury accommodations comparable to what is available in nearby Aspen.

Then the financial crisis wreaked havoc on lenders and developers alike. Today, construction has halted on parts of the 19-acre Base Village, where some buildings are wrapped in plastic. Hypo, which was seized by the German government in 2009, moved to foreclose on the developers in July, saying they missed loan payments. The developers, a partnership including Related Cos., WestPac Investments Colorado, JER Partners, and a unit of Dubai World, responded in August with a countersuit that accused Hypo of a "shameful repudiation" of its obligations.

The resort's fate is a microcosm of all that went wrong for the bank as it handed out more than $8 billion to finance U.S. real estate projects during the property bubble. "Hypo Real Estate jumped on the biggest and most spectacular projects in the U.S. because that was the easiest way to grow quickly," says Wolfgang Gerke, president of the Bavarian Center of Finance in Munich, where Hypo is based. "Their megalomania was what brought them down."

$8.2 BILLION

Hypo's U.S. commercial real estate loans outstanding as of June

Under Evan Denner, who headed the bank's U.S. real estate financing arm, the firm boosted U.S. commercial-property lending, which rose to about $8.2 billion at the end of June from

China's grip on Australia's resources page 44 ▶



829

The number of banks on the Federal Deposit Insurance Corp.'s problem list in the second quarter, up from 775 in the first quarter.

DATA: FDIC

$5.3 billion in 2004. The projects included the Landmark, a luxury condominium and retail development near Denver, and a stalled hotel-condominium project in Phoenix. Hypo has taken control of both properties in the past 18 months, according to Real Capital Analytics. It also provided funding for the W South Beach Hotel & Residences in Florida and the Trump International Hotel & Tower in Hawaii's Waikiki Beach. Denner, who left in 2009, now works at Cantor Fitzgerald. He declined to comment.

Hypo's implosion was Germany's biggest bank failure since World War II. U.S. commercial real estate loans are just a fraction of the up to 210 billion euros ($265 billion) of "non-strategic assets" that Hypo will try to wind down, Gerke says. Yet they loom large for the bank and German taxpayers because they are weighed down by defaults, foreclosures, and litigation. Some 67 percent of Hypo's U.S. real estate loans were on a watchlist or nonperforming at the end of June, according to the company. That's up from 58 percent six months earlier.

Other overseas lenders succumbed to the lure of U.S. property. Foreign banks held $35 billion of U.S. commercial real estate loans as of July, according to data on the Federal Reserve's website. More than $15 billion is classified as troubled, meaning delinquent, defaulted, foreclosed, or in bankruptcy, up from $10 billion a year ago, says Real Capital Analytics. "European banks enthusiastically increased their U.S. commercial real estate lending during the boom," says Ben Thypin, an analyst at Real Capital Analytics in New York.

Hypo executives have three main choices when it comes to dealing with troubled loans, according to Steven N. Kaplan, a professor of finance at the University of Chicago Booth School of Business. They can keep overseeing the loans and manage workouts on their own; sell them for cash, probably at a substantial discount; or partner with private managers, as the Federal Deposit Insurance Corp. has done. "The Germans realize it's difficult to manage these assets but don't want to be embarrassed by a fire sale."

German lawmaker Gerhard Schick, who sat on the government's committee that investigated Hypo, says the bank should shed its U.S. assets. "Hypo went into many markets and expanded without having any on-site know-how," he says. "I still don't see that they have the know-how. The bank should take more of a European perspective and pull back from the U.S."

The Base Village developers filed suit against Hypo and its three partners, all European lenders, seeking more than $406 million in damages for "a transparent effort to evade their contractual obligations." They charge that the lenders failed to deliver funding, which led to the resort running out of money. The banks and the developers declined to comment on the pending litigation.

A foreclosure sale for parts of Base Village is set for Nov. 17. The foundation of the unfinished 30-unit Little Nell Residences at Snowmass, shrouded in plastic, will probably be outfitted with a facade that blends with surrounding buildings in time for this year's ski season, according to Roget Kuhn, 40, a local real estate broker who is selling units in Base Village. "It's good news that there seems to be some path forward," says Kuhn, whose offerings include a two-bedroom, two-bath penthouse for $1.25 million. "This is a great opportunity for anyone who loves skiing. In the long run, this project will be awesome."
—Jonathan Keehner and Oliver Suess

The bottom line *Snowmass Base Village is typical of the glamorous U.S. projects that lured European lenders. Now the project is mired in foreclosure.*

Investing

The Importance of Dividend Payouts

Investors should pay more attention to dividends, which are "a vital element of return," says James Montier, a member of the asset-allocation team at money manager GMO. Dividends accounted for 43 percent of the Standard & Poor's 500-stock index's 394 percent return over the past 20 years.
—David Wilson



FROM LEFT: CHRISTIAN SPROGOE; PETER YANG/AUGUST



Ross has seen a 28 percent drop in Assured Guaranty's stock this year

Insurance

Ross Goes Where Buffett Fears to Tread

- He's the sole player guaranteeing muni bonds. Will the business pay?
- "They can charge a high premium, but the market is still decreasing"

Wilbur Ross has something many business owners might envy: a monopoly in muni bond insurance. The question is, how much money can he make in a shrinking business?

The 72-year-old billionaire is the top individual shareholder in **Assured Guaranty**, the only company left in the $2.8 trillion debt market for municipal bond insurance now that Warren Buffett, 80, has stopped his **Berkshire Hathaway Assurance** from backing new issues. Buffett said last year that deteriorating state and local finances had made the business "dangerous."

Buffett and Ross were left alone in municipals two years ago after the two industry leaders, **MBIA** and **Ambac**, plus **Financial Guaranty Insurance**, the No. 3 company, were stripped of their AAA credit ratings amid losses from insuring mortgage-backed bonds.

Municipal failures have become a concern in the economic slump that began in December 2007. Forty-six issuers have defaulted on about $1.7 billion of municipal bonds this year, the *Distressed Debt Securities* newsletter reported in August. Typically, $1 billion of munis fail in a year, it said. Driving defaults is declining tax income. Collections by states in April, May, and June were 17.2 percent less than in the same period two years ago, the Nelson A. Rockefeller Institute of Government said on Aug. 30.

Shares of Assured, in which Ross is the second-largest shareholder after **Wellington Management**, have tumbled 28 percent this year as of Aug. 31. Berkshire Hathaway B shares have risen 20 percent. The Harrisburg Authority in Pennsylvania, which operates a trash-to-energy incinerator, is the kind of problem that investors are worried about. Assured Guaranty has had to make more than $1 million of missed payments since last year on Authority bonds it insured.

Ross, who declined to comment for this story, remains undeterred. Bermuda-based Assured has backed every state and local bond that carried insurance this year, company filings show. That's about $13 billion of face value in the first half of 2010, according to the documents.

Still, the market for muni bond insurance appears to be declining. At the current pace, Assured's municipal business, including policies acquired when it bought Financial Security Assurance Holdings in 2009, will shrink 45 percent from its 2009 level of $47 billion. Industrywide, the portion of new municipal bonds insured fell to 9 percent last year from 57 percent at its peak in 2005, Standard & Poor's said in a June 24 report on Assured Guaranty. "Investors and issuers are learning to live without insurance," S&P's analysis said.

Assured's AAA credit rank from S&P means an issuer buying its insurance takes on that rating, making its securities more attractive to investors and reducing borrowing costs. That's becoming less necessary as investors fleeing declining stock markets pour cash into municipals and U.S. Treasuries, pushing tax-exempt yields to record lows. Also, Moody's and Fitch Ratings recalibrated their credit scores this year so the default risk of munis could be compared with that of corporate bonds. The change led to higher grades for many cities and states, lessening their need for insurance.

"Having a monopoly isn't going to do them any good," Gao Liu, who teaches public policy and administration at the University of New Mexico at Albuquerque, says of Assured Guaranty. "They can charge a high premium, but the market is still decreasing."

—*Christine Richard and Darrell Preston*

The bottom line *While Assured Guaranty is the sole active muni bond insurer, profits are threatened by growing default risk and less demand for coverage.*

Stock Market

Why Analysts Don't Want to Say 'Buy'

- They see earnings soaring but worry about the economy
- "Companies look pretty good. ... What if there's a double dip?"

Meyer Shields says earnings at Warren Buffett's **Berkshire Hathaway** will increase the most since 2006 this year. He's also telling investors to sell the shares because the economic recovery is weakening.

When it comes to sending mixed messages, the Stifel Nicolaus analyst has plenty of company. For the first time since at least 1997, fewer than 29 percent of ratings on stocks covered by brokerages worldwide are "buys," according to 159,919 recommendations compiled and tracked by Bloomberg. Analysts are turning more pessimistic even as they push up profit-growth estimates among Standard

& Poor's 500-stock index companies to 36 percent, the highest since 1988.

"People are sitting on a fence," says Paul Zemsky, the New York-based head of asset allocation for **ING Investment Management**, which oversees $550 billion. "When I go and talk to our equity analysts, they look at the companies and say, 'Boy, these companies look pretty good, earnings are O.K., they have plenty of cash. What if there's a double dip?'"

Another reason Wall Street firms are becoming more reluctant to award "buy" ratings is that individual U.S. stocks are moving more in lockstep than they typically do. That limits the opportunity for analysts to identify outperformers, says John Praveen, chief investment strategist at **Prudential International Investments Advisers**.

The caution extends beyond the U.S. More than 54 percent of ratings for companies in the U.S., U.K., Japan, and Brazil are "holds," the highest level since Bloomberg began tracking the data in 1997. While the proportion of "sell" ratings in the U.S. has fallen to 5.1 percent, half the level of 2003, the total combined with "holds" reached a record 71 percent last month, the data show.

While pessimism is increasing, analysts say profits for companies in the MSCI World Index of 24 developed nations will gain 28 percent in the next year. The MSCI index trades at 11.4 times forecast profit, data compiled by Bloomberg show. Except for the six months starting October 2008, the index has never traded below 12.5 times annual earnings.

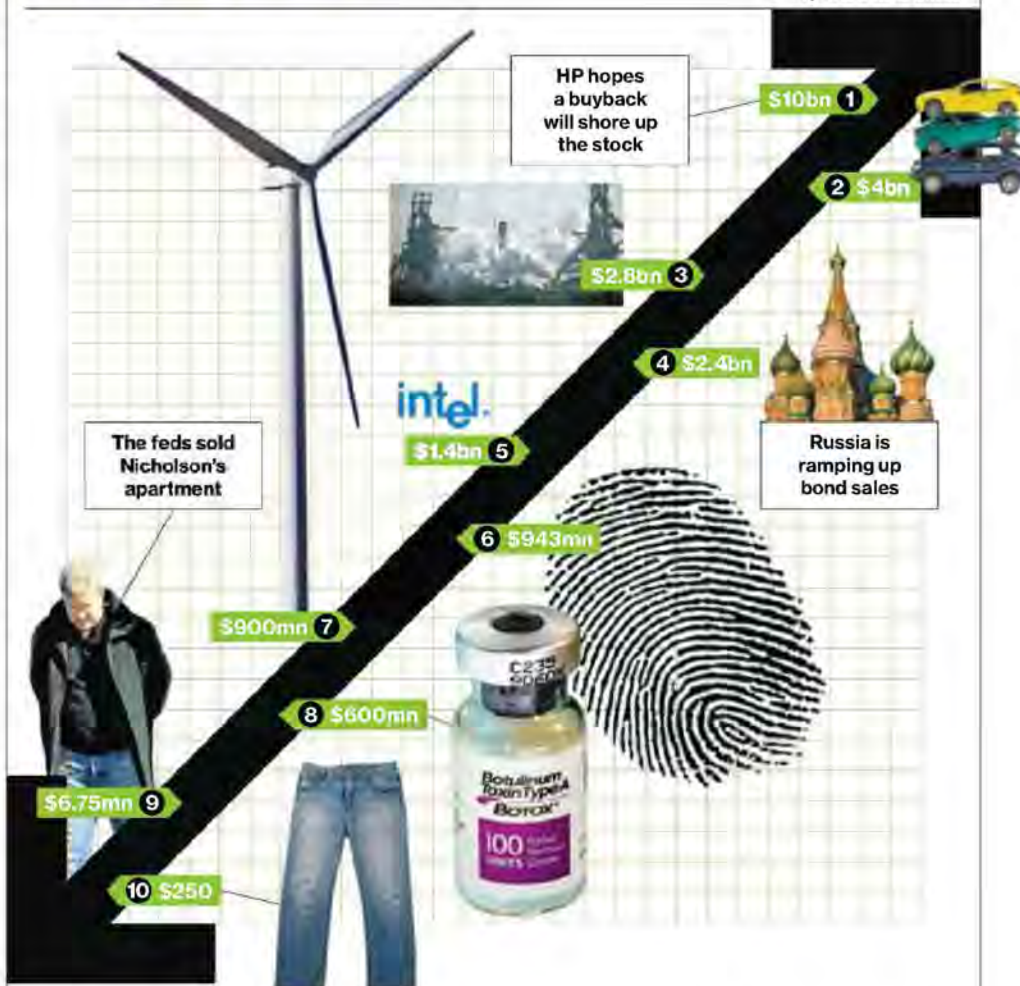
Shields says his biggest concern is that joblessness will weaken consumer spending, which accounts for 70 percent of the U.S. economy. "Employment is much worse than what people have anticipated," he says. "If I had to pick one single factor that underlies our negativity, that's what it is."

E. William Stone, chief investment strategist at **PNC Wealth Management** in Philadelphia, says widespread nervousness about the economy is "a positive" because it gives investors a chance to find "a good company that's being dragged down by the overall market." B
—Rita Nazareth and Lynn Thomasson

The bottom line *Analysts see companies boosting profits considerably but worry that economic weakness will sabotage their forecasts.*

Bid & Ask

by Cristina Lindblad



1 **Hewlett-Packard's** board approved $10 billion for share repurchases, adding to the $4.9 billion already available, in a move that may help shore up HP's share price. The personal-computer and printer maker's stock is down some 25 percent this year, in part because of the sudden departure of Chief Executive Mark Hurd in August.

2 Spain's **Banco Santander** paid $4 billion for a portfolio of U.S. auto loans held by HSBC Holdings. Santander is seeking to expand globally to compensate for weak loan demand and rising rates at home.

3 South Korea's **Posco**, the world's No. 3 steelmaker, acquired Daewoo International, a steel and crude oil trader, for $2.8 billion. Daewoo already handles about one-quarter of Posco's steel exports.

4 **Russia** tried to sell $2.4 billion of federal local currency bonds, the largest amount offered since the central bank began keeping data in 2003. Investors bought only 16 percent of the bonds that were available, but that was an improvement on the results of a previous auction.

5 **Intel** paid $1.4 billion for Infineon Technology's wireless unit to secure a foothold in the mobile-phone market it has struggled to crack for more than a decade.

6 **3M** bought Cogent Systems, a Pasadena (Calif.) maker of biometric identification systems, for $943 million. Best known for its Post-it Notes and Scotch tape, 3M also manufactures systems for issuing IDs, passports, and visas.

7 **Exelon**, the largest U.S. utility owner, offered a much as $900 million for Deere's renewable-energy unit, NewAlliance. The deal will advance Exelon's 2008 promise to reduce carbon emissions.

8 **Allergan**, the maker of wrinkle smoother Botox, agreed to pay $600 million and pled guilty to a misdemeanor charge to settle a U.S. investigation into its marketing practices.

9 The U.S. Marshals Office sold the New York City apartment of onetime hedge fund manager and admitted **Ponzi schemer James Nicholson** for $6.75 million.

10 In exchange for making a charitable donation of $250 or more, employees at **Goldman Sachs** enjoyed the privilege of wearing jeans to work on Fridays in August.

CLOCKWISE FROM TOP: GETTY IMAGES (2); ALAMY; GETTY IMAGES (2); MARC HERMAN/DAILY NEWS; GETTY IMAGES; AFP/NEWSCOM; JEAN CHUNG/BLOOMBERG


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The deal is Australia g China gets

How's that supposed to make a country feel? By Malcolm Knox


simple.
ets money,
Australia.

Every third Wednesday, Michael Box gets up at 3:30 in the morning to catch a flight out of Perth. Isolated in the south-west of Australia, Perth (pop. 1.6 million) is 1,700 miles from the next large city, Adelaide, which isn't even that big. Box and about a dozen co-workers fly two hours north to a yet more remote section of Australia, the Pilbara, a 193,000-square-mile hump of territory arcing into the Indian Ocean. They will land on this patch of iron-rich red earth and spend the next two weeks sending as much of it as they can, about a million tons a day, to China.

The Pilbara—the word is Aboriginal for mullet, a type of fish running in the mountain creeks—is both the end of the earth and the wellspring of Australia's future. The desolate region was home to indigenous people for millennia, then to the stockmen and adventurers who populate fantasies of the outback. It is the last place you would expect to find a businessman from China, let alone several thousand native Chinese.

Here, representatives of Chinese companies Chinalco, CITIC, Sinosteel, Ansteel, and China Metallurgical Group work alongside employees of BHP Billiton and other mining companies, like Box's employer, Rio Tinto, in which China has an interest. Among their jobs—which include building power stations, desalination plants, and other infrastructure around the mines—is overseeing the removal of the iron ore, which is loaded onto 325-yard-long bulk carriers waiting by purpose-built wharves 500 yards long. (Construction has begun on a still larger installation, including a 1.1 mile long jetty.) About eight of these massive ships leave every day.

The red earth here contains an estimated 24 billion tons of iron ore. In the 1970s it left in smaller quantities and returned to Australia in Toyotas and Mazdas; now the dirt is going offshore forever, to house and transport workers in the cities of China. In this earth lies Australia's miracle economy, which has seen its gross domestic product grow 3.2 percent in the last year.

If you were searching for someone who has handled as much of this dirt as anyone in the past 40 years, you would find Box, 53, one of the 45,000 Australians who live and work in the Pilbara region. Everyone calls him "Boxy," as he is named on his navy-blue overalls and dayglo vest. "Call me any other name, I won't know who you're talking to," he says.

As a teenager in the 1970s, Boxy came up here to work for Hamersley Iron, building the town of Paraburdoo to support workers in the Pilbara mines. For 92¢ an hour he was one of "a tribe of dogsbodies," as he calls manual laborers, "carting sand and rocks, planting lawns, building retaining walls, then moving into the mine, crushing and screening iron ore, then loading it onto the trains."

Thirty-five years later Boxy is still here, now earning A$145,000 ($129,000) a year as a truck operator for Rio Tinto, his waist thickened by his love of beer, his eyesight aided by thick-rimmed glasses, and with a "hole in my hair that grew as big as my head."

By 7:30 a.m. he is in his room in a three-bedroom prefab donga in the miners' camp. A donga is a rudimentary shack, dusted with red dirt but fitted out with flat-screen TVs, sophisticated communications, and creature comforts. After breakfast and a change, he arrives at the West Angeles mine, one of a cluster of mega-mine sites in the Hamersley Ranges. By 8:30 he's at work.

In his time, Boxy has done "just about every job in mining," but his great love is driving big trucks. "After 11 years, I got to drive a 100-ton Wabco truck, working with loaders and bulldozers," he remembers. "We were just like boys in a sandpit." He now oversees a test project of driverless Komatsu trucks that cart out 300 tons at a time, moving 80,000 tons over two 12-hour shifts. When the drilling is good, he says, they can shift 120,000 tons in 24 hours. Without drivers, the trucks are more reliable, with radar sensors stopping them from crashing. They roll 24 hours a day.

A$104k

Average annual salary in Australia's mining industry

While it's a complex industry, at the basic level mining is dead-simple: Dirt is dug from the ground, loaded onto trucks, taken to trains, then put on boats. It is the scale that stuns, particularly in this operation. The trucks are two stories tall. The trains are two miles long, and they pour like rivers down the mountains to the coast, where the carrier ships await. The million tons of ore the ships carry away each day is up by 70 percent in the past five years, and most of it is bound for China.

As large as the Pilbara project is, it is just one of many China has funded in a boom that has both enriched and troubled Australia. The Chinese aluminum company Chinalco owns about 9 percent of Boxy's employer Rio Tinto, which has been transformed by China's demand for iron ore into the second-largest miner in the world. Rio Tinto, which had a net income of $1.4 billion in 2003, now earns more than $10 billion a year, and 70 percent of those profits are from iron ore. Until last year, China was trying to buy more of the company, a move resisted by Rio, which would have had its largest customer even more involved in decision-making.

China buys A$22 billion worth of iron ore from Australia each year. In 2009, according to the Australian government, nearly a quarter of the country's exports, A$42.4 billion worth, went to China. The year-on-year growth was 31 percent.

The billions pouring in from China have helped Australia escape the global recession and enjoy a national unemployment rate of just 5.1 percent, about what it was before the financial crisis crushed many other economies.

"A 20-year-old off the street can come up to the Pilbara and earn A$92,000 a year," says Boxy. The median household income in Australia is A$67,000. "He can fly in and fly out 17 times a year for two-week stints, like I do, and he'd be silly not to."

The benefits for Australia in becoming China's quarry are quantifiable and visible, says Tim Harcourt, the chief economist for the government trade organization Austrade. "Our economic relationship with China adds A$3,400 per annum to every Australian household through exports, imports, and foreign investment," he says.

The greater part of China's interest in Australia lies in the ground. Chevron's Gorgon natural gas project at Barrow Island, off the northwest coast of Western Australia, will cost $37 billion to build and employ 6,000. China has committed to buying gas from the project for 20 years. Chevron is also developing a liquefied natural gas (LNG) project at Wheatstone in the same area that will produce an estimated 8.6 million tons of LNG annually. As a consequence, property prices in central Pilbara rose by 230 percent last year, according to RP Data.

PREVIOUS SPREAD: CHRISTIAN SPROGOE. THIS SPREAD, FROM TOP: MARK GRAHAM/AP; CHRISTIAN SPROGOE



Chinese Vice-President Xi Jinping shakes hands with Fortescue Metals CEO Andrew Forrest during a five-day visit in June 2010; then-Prime Minister Kevin Rudd looks on

Chinese resource investment comes in three main forms: In the year leading up to July 2009, Australia saw A$42.4 billion in export demand, A$3 billion of direct investment in Australian companies, and more than A$4.9 billion in other project financing. More than 60 new direct Chinese investment projects have been approved this year by Australia's Foreign Investment Review Board and are expected to total A$23 billion over their lives. Huge mining projects need the type of capital that is not easily available within Australia, and 99 percent of current Chinese investment in the country is in the resources sector.

Direct investment has been politically charged, with Chinese bids to take over or increase their shares in miners such as Rio Tinto and Oz Minerals blocked by management and the government, respectively. (A portion of Oz Minerals was purchased in June 2009 for $1.35 billion, however.) The Australian Foreign Investment Review Board has issued guidelines suggesting that Chinese direct investment in Australian companies remain below 50 percent, but no such law has been passed. This has not harmed Chinese financing. In June the China Development Bank signed a $1.1 billion loan facility for the $1.8 billion Karara iron ore project in Western Australia, developed by Australia's Gindalbie Metals and China's Angang Steel, as well as deals to fund Aquila Resources' A$5.8 billion West Pilbara iron ore project and Fortescue Metals' various Pilbara iron ore projects.

The consequences of a A$6.6 billion trade surplus with China are evident on Australia's streets as much in what is unseen as what is seen: There are no dole lines, no rash of real estate foreclosures, and little of the social unrest that has followed economic downturns elsewhere.



Rio Tinto's ore trucks at the Pilbara carry 300 tons and roll 24 hours a day

Politically, China treats Australia as a serious partner. Three of its politburo standing committee members have visited Australia in the past 15 months, including Vice-President Xi Jinping in June, who noted the "advancement of the China-Australia relations at large." Talks are under way for a free-trade agreement, and an annual Australia-China Strategic Dialogue has been inaugurated.

Economic and diplomatic advances, however, have not fueled a warm national glow. Australia's proposal to increase taxes on mining became a national issue, precipitating a three-month barrage of anti-government campaigns paid for by the mining industry, which in part led to the removal in June of Prime Minister Kevin Rudd, a Chinese-speaking former diplomat. In the August federal election, the ruling center-left Australian Labor Party lost its majority due in large part to massive swings against it in the resource-rich states of Western Australia and Queensland. Supporters of the tax argue that the resources are not coming back and that Australia should participate more fully in the outsize profits. Those against include the mine operators and the many who work in the mines; mining salaries are, on average, Australia's highest, according to the Australian Bureau of Statistics.

The countries' diplomatic ties were also strained in early 2010 with the opaque trial and imprisonment in China of Stern Hu, an Australian convicted of accepting bribes and spying while working for Rio Tinto. He is to spend 10 years in prison. Hu was arrested a month after Rio Tinto rebuffed state-owned Chinalco's attempt to double its stake in the company.

Mining executives and other Australian businesspeople dealing with China were reluctant to comment on the Hu case. The Chinese embassy in Australia did not respond to a request to make a spokesman available.

China's hunger for Australian resources has aggravated the deepest divisions in Australian society over population size, immigration rates, taxation, and infrastructure. Bob Kinnaird, formerly of the Department of Immigration and Citizenship and now a private consultant, warns: "The huge growth of the Chinese presence in Australia, through the mining boom, students, tourism, and permanent migration, has been mismanaged to an incredible degree. The industries involved have urged extraordinary growth, but there hasn't been

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the infrastructure support to cope with it, and the result is that large numbers of Australians in the cities are worried that while the economic indicators are going one way, their real living standards feel like they are going the other."

Public opinion reflects this ambivalence. In new polling conducted by the Lowy Institute for International Policy, an Australian think tank, 73 percent of Australians say Chinese economic growth has been positive, but 57 percent say there is now too much Chinese investment. Economic power has brought fear, too: 46 percent believe China will pose a military threat within the next 20 years.

Fergus Hanson conducted the polling. "In some ways," he says, "these polls repeat what was happening with Japan two decades ago. In 1988, 70 percent of Australians said we had too much Japanese investment, even though they thought it had been good for Australia. The difference now is that the ambivalence over the future comes with fears about the motivations of an authoritarian central government."

In the markets, speculators, unable to bet on a yuan pegged to the U.S. dollar, use the currencies of China's main trading partners instead. That has helped make the Australian dollar the fifth-most-traded currency in the world—after the U.S. dollar, the yen, the pound, and the euro—even though Australia is the 18th largest economy. It has also made it more volatile. In May it fell by almost 10 percent in one day when traders sold it as a proxy for China, after Chinese growth forecasts were downgraded.

It's in the towns, however, where the boom is most powerfully felt—and least trusted, especially as projects are prepared for and sometimes abandoned. In Ravensthorpe, in the Pilbara, the shelving of a nickel mine cost a projected 6,000 jobs. ("When I first went to Paraburdoo in the Pilbara in the 1970s," remembers Box, "the place was only half-built from the 1960s boom. It had been shut down when the boom ended.")

Wandoan, a hamlet of 300 homes in outback Queensland, on the eastern side of Australia, is hanging by a Chinese thread right now. Life there has become contingent on decisions in steel towns in China or at the headquarters of Mainland-based multinationals. Mining giant Xstrata, to take one example, has been planning a A$6 billion coal mine that is part of a A$150 billion complex of projects in central Queensland to export coal and LNG to Asia.



Box has worked the Pilbara since the 1970s.
He's seen booms and busts, but never a boom like this one

31%

Current year-on-year growth in Australia's exports to China

Ray Mortimer is a local real estate agent and head of the town's business chamber. "The mine's been on the drawing board for a long time," he says, "and people feel like they're being strung along. Xstrata has bought 70,000 acres of the most beautiful grazing land for seven mines. Forty families were coming to grips with whether to take the money or stay where they've been for generations and didn't really want to leave. When they did leave, it caused the local supermarket to close down. Then Xstrata stopped buying. Then two months ago it was on again, but now it's up in the air again."

The consequence, in the small towns whose livelihoods hinge on those decisions, is a sense of helplessness.

"There are deeply mixed feelings over the mine," says Mortimer. "Older people have no sense that this is going to be good for the district, because all they see is their communities being decimated. For the businesses who are meant to profit, whether it's mine mechanics or hardware or all the small businesses in the towns, they don't know from one week to the next whether they're going to have a job or not."

Dina Fraser, whose family has owned the local pharmacy in Wandoan for 40 years, says the mine project has been anything but a blessing. "A lot of people have lost their properties to acquisitions by the mine and some have left town," she says. "If the mine doesn't happen, the town might just fade away. There's great upheaval about it and a happy farming community has been turned into something else, and you could say a lot of people wish the resources were somewhere else."

Unpredictability brings anxiety and hope in equal measure to the 8,000 Aborigines in the Pilbara, who hope their third-world living conditions might be raised by the China boom. Tony Wiltshire, an indigenous mechanic who runs a guild of Aboriginal businesses and tradesmen in the Pilbara, says the mining boom's benefits could sidestep the local population.

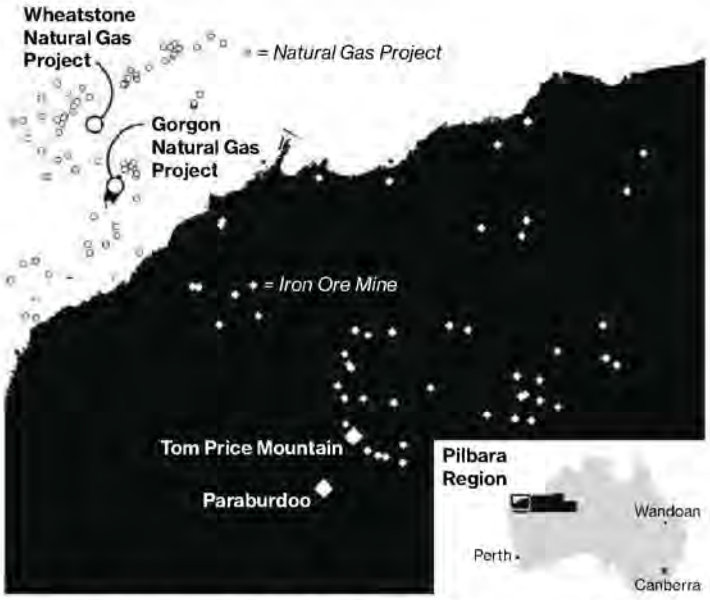
"The reality is that industrial discrimination against local people is huge," he says. "The big corporations fly workers in and out, and see these mines as short-term projects."

Charlie Williams, a 55-year-old Aboriginal electrician who had worked on the east coast all his life, decided to fly west and try his luck three years ago. "I went to Perth and qualified as an electrical contractor," says Williams, who now works on electrical maintenance in BHP Billiton's rail yards at Nelson Point, on the Pilbara coast. "My main aim is to get Aboriginal apprentices into work," he says. "There's a terrible cycle of poverty for Aboriginal people, and the mining industry can either break that cycle or it can pass us by."

Williams, a graying, bespectacled, and fair-skinned Aboriginal man, has Chinese blood on his mother's side. Chinese immigration to Australia started in the 1850s gold rushes, and that diaspora spread through the country, including to north Queensland, where Williams' people come from. "I'm colorblind on these things," he says. "China is just a customer, and if they can bring us jobs, that's what China means to me."

But if it's just a customer, what are its obligations to the supplier? Tony Wiltshire asks a question that is a perennial for citizens of a land that is used as a quarry: "Are they just here

PHOTOGRAPH BY SABINE ALBERS FOR BLOOMBERG BUSINESSWEEK



to make a buck and go, or build something sustainable? The question is whether we're going to have mines with towns, or towns with mines."

That question speaks to the rest of Australia. In June, Wiltshire was one of many locals surprised to see the Sino mine project in the Pilbara advertise for riggers, crane operators, and fitters who speak Mandarin. As an unhappy union official named Joe McDonald put it: "The only bloke I know who can speak Mandarin is Kevin Rudd."

John Sutton, the national secretary of the Construction, Forestry, Mining and Energy Union (CFMEU), the biggest representative of Australian mine workers, voices a widely held concern: "As more Chinese investment comes in, it's inevitable that they'll want to bring in their own workforce, with lower costs and conditions than the locals. Why else would a company advertise in a way that shuts out pretty much every Australian job applicant?"

Or, as Kinnaird puts it: "We've seen it before in the 1980s, when Japanese companies brought in Japanese-speaking workers. When the Japanese economy busted and they pulled out of Australia, they left nothing for the local workforce."

It is all a jarring turnaround in a long relationship. For most of the 20th century, Australia had an immigration policy that was biased against non-Europeans. Although Australia recognised the People's Republic of China in 1972, ahead of many Western governments, trade with communist China was minimal until this decade. A precedent existed, however, in Japan, which went from Australia's No. 1 military threat to its biggest trading partner in the space of a generation.

With such an unexpected and rapid windfall, from a country with a suspect record on human rights and unknown intentions for its trading partners, it is perhaps normal for many Australians to look for a catch. Fergus Hanson's polling shows a recent pushback against China. "Record numbers of Australians support our alliance with the USA," he writes. "Part of that is the popularity of Barack Obama, but a bigger part is fear of China." These findings were backed up by a survey of 2,000 investors in January 2010 by Fairfax Media newspapers, in which only one in five had positive feelings about Chinese investment. Others were worried by China's human rights record, or that China's state-owned enterprises would act against Australia's interests.

At street level, there is little evidence of ethnic tension. Chinese businesses are long-established not only in Australian cities but in small rural towns. "Chinese immigrants were here very soon after the Europeans," says Kinnaird, "They've long been a part of Australian life."

There has been no recent reporting of race-related violence against Chinese in Australia, as compared with the well-publicized attacks on Indian students in 2009, the riots directed at Middle-Eastern immigrants in 2005, and national anxiety over asylum seekers from South Asia. Says Kinnaird, "The tension you do see is related to labor markets specifically, through workers coming in from China on short-term visas, rather than a broader social phenomenon directed at Chinese-Australians."

For union leader Sutton, it boils down to what the Chinese companies build and leave here. "The big mining companies have tended to see themselves as visitors to an area, flying in and flying out," he says. "What's needed is for governments to insist on them contributing to the building of schools, roads, hospitals, permanent housing, all the things that are going to leave these towns better than before. As long as the companies aren't doing that, the fear for Australia workers is that Chinese companies will just be building camps to fly in and fly out Chinese workers on temporary visas, to work for less pay and worse conditions, and deprive Australians of the benefits that they are due."

One of the local councils in the Pilbara, Shire of Ashburton, recently refused permission to Rio Tinto to expand its camp around the Tom Price mine. Instead the company has been asked to invest in facilities that will remain after the mine is closed, to spend $247 million on housing, an air strip, and other infrastructure at the town of Pannawonica. This kind of investment, and the employing of locals, is the only move that is going to convince skeptics like Tony Wiltshire.

"We were at a town meeting the other day when a representative from a mining company said, 'Come on, we're all up here to make a dollar.' The locals in the room looked at each other and thought, 'What?' We live here. We can cope with the hot summers. We're here for the long term. We are actually better for the multinationals than the contractors they fly in and fly out. We just need them to wake up to the fact that they, and we, are all in it for the long haul."

Like many miners making money off the boom, though, Michael Box is optimistic.

"I'm a simple man, but I've had a good life," he says. "My total salary and superannuation is A$145,000 a year, and when I'm in the Pilbara I don't have to put my hand in my pocket. I have a house in the city and an investment property and a 1972 Falcon pickup. I couldn't have had this life without mining."

And though he has seen booms go bust, his confidence stretches as far over the horizon as Australia's economy seems to. "When my 18-year-old son Christopher was wondering what to do with his life, I showed him everything I've got from driving trucks and carrying dirt," says Box. "He's decided to study mining engineering. I'll be proud as punch if he ends up being one of my bosses." B

A$3,400

Gain per year to each Australian household via trade with China

The uncovering of a Ponzi scheme that exploited a surprisingly perfect dupe – law enforcement.

Niche-Market Madoff

By Robert Schmidt
Illustrations by Matthew Woodson

Kenneth Wayne McLeod, 48, covered in tattoos, with a shaved head and plenty of stubble, looked more like an undercover detective than a financial expert. For more than 20 years, he gave seminars explaining how to get the most out of government retirement benefits, drawing rave reviews from the FBI, Drug Enforcement Administration, Immigration and Customs Enforcement, and U.S. Customs and Border Protection employees he was hired to teach. Thousands of agents heard the pitch, often at the beginning and end of their careers, when their financial decisions mattered the most. The U.S. government gave tacit approval to McLeod's credentials; he contracted with agencies, including the Homeland Security Dept. and the IRS, and some paid him as much as $15,000 per seminar. According to his own marketing materials, McLeod's benefits company gave 250 presentations to law enforcement agencies since 2006. In recent years, as federal budgets got tight, McLeod gave them for free, relying on his connections with the agencies' managers to keep the invitations coming.

He did these freebies because in addition to dispensing advice, McLeod signed up audience members for his own money management firm, F&S Asset Management Group, which oversaw $43 million for 1,100 people, almost all of them current or retired law enforcement. "It's hard to get into the law enforcement community," says Howard "Ike" Hendershot, president of a group of retired secret service officers that invested with McLeod and invited him to give a seminar at their conference in Hawaii in 2008. "Once you're in, you find that other agents trust agents, cops trust cops."

McLeod also met new clients through charity work he did for nonprofit groups that support the families of agents killed in the line of duty. He was a regular sponsor of golf tournaments held by the DEA Survivors Benefit Fund. McLeod was a guy's guy: He loved to talk about sports, particularly University of Georgia football, the school from which he claimed to be an alum. Along with naming his boat *Top Dawg*, a play on the team's nickname, McLeod liked to brag that his own dog was a direct descendant of the original Uga, the football team's bulldog mascot. He made a big deal about attending the annual Georgia-Florida game, which is held in Jacksonville, frequently reminding people that it was known as the "world's largest outdoor cocktail party."

Although his company was a bit player compared with other money managers, it enabled him to lead a luxurious life that included trips to the Super Bowl for himself and dozens of his friends; suites at Jacksonville Jaguars football games; a million-dollar riverfront home with his 38-foot boat moored in the back; and several luxury condominiums on Florida's Amelia Island. McLeod hyped to potential investors that FBI Director Robert Mueller was a renter.

McLeod lured them with what he called his "special fund," government bonds that he promised would return 8 percent to 10 percent interest annually, tax-free. Few if any clients bothered to ask how such good returns could be duplicated year after year. Like those who put their money with



Bernie Madoff, they didn't think they were being too greedy. They weren't trying to get rich overnight. It all sounded perfectly reasonable. Then, in June, working on a phoned-in tip, investigators from the Securities and Exchange Commission barged into McLeod's Jacksonville office. They grilled him for two days until he finally broke down and admitted that for two decades, he had been conning people who carry guns for a living–a Ponzi scheme with a peculiar twist.

As primitive as they are, Ponzi schemes are not easy to spot. As long as money flowing in from new investors covers the payouts to current investors, nobody wises up to the fraud. That often changes during tough economic times as more clients try to withdraw money and the requests can't be covered. That was what led to the discovery of Madoff's $65 billion fraud in December 2008 and R. Allen Stanford's alleged $7 billion scheme. (Stanford has denied all wrongdoing and is scheduled for trial in January.)

The financial crisis also led to the arrests of a string of "mini-Madoffs," whose crimes, while not as massive, were just as brazen. They include New York money manager Kenneth Starr, arrested in May and charged with stealing at least $59 million from movie stars and other celebrities. Starr has pleaded not guilty, and his trial is scheduled for November. What sets McLeod apart from the other mini-Madoffs is his client list: It's the first time, authorities say, that anyone has dared to rip off an entire group of law enforcement officers.

At the time the fraud was uncovered, about 150 people thought they had money in McLeod's special bond fund, according to the SEC, totaling $34 million in missing funds. Overall, 260 investors cycled through, many having been referred by friends and colleagues. The clients McLeod scammed were those who had invested in the bond fund. His F&S Asset Management Group was legitimate, and many of those investors, including Hendershot's secret service group, didn't have their money stolen.

Fraud experts say McLeod ran a classic scheme where there were few warning signs about what was really going on. He targeted a like-minded group of people and ingratiated himself however he could. He told them "anything they wanted to hear," McLeod explained to an SEC investigator.

Research has shown that males between the ages of 55 and 64–the bulk of McLeod's client list–are the most typical investment fraud victims, according to Lori Schock, the head of investor education at the SEC. As a group they are financially more literate than most, yet are willing to take bigger risks while doing less due diligence. "Affinity fraud can happen anywhere," Schock says. "It's buyer beware at all times."

McLeod had a background very similar to his clients. He grew up in Jacksonville, graduated from high school there in 1980, and went into the insurance business. He never attended the University of Georgia, and until starting his "special fund" didn't seem destined for financial success. He filed for bankruptcy shortly after marrying his first wife, Sheila, in 1987, and opened his consulting company, Federal Employee Benefits Group, that year. The firm advertised assistance with "getting the most out of your federal benefits," with a specialty in "the complex issues surrounding special group employees, including law enforcement officers, firefighters and air traffic controllers."

Unlike most government employees, federal law enforcement officers are required to retire at 57. If they have 20 years of service they can quit with full benefits anytime after hitting 50. As a perk, their agencies offer a series of training seminars on how to navigate the often arcane rules underpinning the federal retirement system. The training usually is offered at the beginning of their careers, then again several years before they are eligible to leave. Agents are often encouraged to attend multiple classes and even to bring their wives.

In his presentations, McLeod taught agents how to allocate investments in their retirement accounts and helped them estimate how much money they would need in retirement. He walked his pupils through a dizzying maze of retirement programs with acronyms like FERS and CSRS and FEGLI. He'd tell them about the "windfall elimination provision," which deals with how pensions affect Social Security, and remind them not to forget their military service time in calculating their retirement packages. Frozen sick leave or government pension offset rules? He knew how to handle them as well. He told the agents how to take advantage of the government's matching contributions to their Thrift Savings Plans and when they could begin withdrawing the money. He offered predictions for where the markets were heading and which were the best funds for earning high returns. And at the end, always, McLeod



Snapshots from Kenneth Wayne McLeod's 1980 yearbook at Forrest High School, where he was a senior, varsity athlete, and Pheta Club president

McLeod's home in Jacksonville, Fla.

McLeod was a guy's guy; he loved sports, especially University of Georgia football

THE FLORIDA TIMES-UNION (5)


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would encourage anyone needing more help to get in touch.

In the mid-1990s, even as McLeod was beginning to take his seminar business on the road and speak to law enforcement officers across the country, his company didn't make much money. When he and Sheila divorced in 1995, they had very little to divide up: He was required to pay $200 a week child support for their four children. He also took the 1993 Jeep Cherokee and the wide-screen television—neither of which had been paid off yet—along with the washer and dryer. Sheila kept the 1993 Ford Aerostar van, with Wayne taking responsibility for the car loan.

By 1998, McLeod's business appeared to be booming. He purchased a new home in Jacksonville and had a growing stable of clients. His increase in wealth came to the attention of his ex-wife, who hauled him back into court to increase her child support. The settlement called for increasing the payments to $2,100 a month. A few years later, McLeod married again. He and his new wife, Susan, had one child.

The rise in McLeod's personal finances coincided with the growth of his "special" bond fund. McLeod seemed to target agents who had been promoted to supervisory roles, jobs that required them to move frequently. While law enforcement officers don't make big salaries, some are able to build substantial nest eggs buying and selling their homes. McLeod zeroed in on that money.

Douglas Garner, who has worked for 22 years for the agency now known as Customs and Border Protection, met McLeod in 1998 at a seminar in Corpus Christi, Tex. It was the first of five training sessions that Garner attended with McLeod or representatives of his company. At one conference for special agents in charge of regional offices that Garner went to in Washington several years later, he says, McLeod was introduced and praised by the agency's most senior leaders. They encouraged the office chiefs to hire McLeod in their home states, according to Garner, who booked the investment adviser for programs when he ran offices in Texas and Florida. "It was clear that he was endorsed by our own top of the chain," Garner says.

After being transferred to Washington and selling his home in Texas, Garner asked McLeod what to do with the profits, about $85,000. He recommended they be placed in the special bond fund. The investors, McLeod claimed, were his "exclusive clientele," including high-ranking government officials, federal judges, and a Supreme Court justice.

McLeod encouraged Garner to buy his new house in the Washington area using an interest-only loan with no money down, pointing out that his house profits from Texas would make more money in the guaranteed bond fund. The move worked so well that when Garner was next transferred to Florida, he did the same thing, plowing about $90,000 in profit from selling his home in the D.C. suburbs into the fund. He bought a house in St. Augustine on another interest-only loan.

Because of the success of his investments, Garner says he didn't object when McLeod encouraged Garner's father to buy into the fund in 2007. After cashing out stocks and other investments and paying about $30,000 in broker fees, Harold Garner gave McLeod $599,728. It is all gone.

Now 52, Douglas Garner has a mortgage that is about to reset at a higher interest rate, and he still has to put two of his six children through college. He has been consulting an accountant to figure out how to stabilize his finances. "I am the poster child," says Garner, who lost almost $800,000 of his and his father's money in the scam. "My life is what you would call upside down right now."

McLeod lured them in with his "special" bond fund, which he promised would return 8 percent to 10 percent interest annually, tax-free. Few if any clients bothered to ask questions

Former DEA agent Kurt Coront and his wife, Claire, who were also investors, began to grow suspicious of McLeod toward the end of 2009 when he became more evasive about their investment questions. Fearing the worst, both began to look for jobs. After consulting with attorneys, Coront complained about McLeod to the SEC and the Financial Industry Regulatory Authority (FINRA), the self-regulatory agency for the brokerage industry.

Over eight years, Coront and his wife had put in $458,500, coming mostly from the profits of two home sales and a small family inheritance. At times Coront also withdrew money from the fund, getting back $202,500. After consulting with McLeod, Coront says he had decided to retire in 2005 at age 53. He bought a smaller house in Bradenton, Fla., and was learning to enjoy life outside the front lines of the drug wars.

Coront says he terminated McLeod as his investment adviser in early 2010 and asked to redeem the entire balance in his bond account. He never got the money. He now has a job teaching criminal justice at a local campus of the ITT Technical Institute. His wife also works there as a receptionist. "Without the jobs, we'd be out on the street," he says.

Coront's calls to the SEC and FINRA on May 17 coincided with a dispute McLeod had had with the firm he used to register as a broker (a relationship he needed to sell clients variable annuities), which ended with McLeod quitting. The move triggered a requirement that the company, Lincoln Financial Securities (which is not accused of wrongdoing), notify FINRA about the change. Though often routine, the notifications have taken on a new significance at the Washington-based regulator in the wake of the Madoff scandal and after FINRA created a new fraud detection office last year. Cameron K. Funkhouser, executive vice-president of the Office of Fraud Detection and Market Intelligence at FINRA, has pushed his junior staff to scrutinize the notifications. When McLeod's came in, Sharon Kravitz, an analyst, flagged it.

Once the case was in Funkhouser's hands, he did what any top investigator would do: He Googled. "I wish I could say this was brilliant, but it was brilliant in its simplicity," Funkhouser says. The results were disturbing. One warning sign was that McLeod's education and experience weren't typical of other experts in the profession. Funkhouser also came across a local news clip of McLeod loading coolers onto a chartered bus for a trip to the Super Bowl in Miami. McLeod told the reporter that he had been paying for such trips for the past six years.

FINRA investigators got in touch with some of McLeod's clients and asked McLeod himself to come to Washington for an interview. McLeod demurred, saying he was

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unable to make the trip due to his busy schedule and some financial troubles. After Funkhouser heard the response, he got a sickening feeling. He and his deputies picked up the phone and called McLeod himself. "He did exactly what I expected him to do, which is he talked," Funkhouser says. "He basically went into the sales pitch."

McLeod insisted he had nothing to hide and told Funkhouser that he could ask any senior official at a law enforcement agency and he would know who Wayne McLeod was. He said he was very good friends with FBI Director Mueller and that the two played golf together. McLeod described his sponsorship of DEA survivors' golf tournaments, telling Funkhouser it was "all about the families." When asked about a special bond fund he might run, McLeod said he didn't have one.

After the call, Funkhouser alerted the SEC and suggested they needed to send inspectors out to Jacksonville and prepare court papers to freeze McLeod's assets. A few days later, the SEC did just that. On the second day of his SEC interview, McLeod admitted to the entire scam, and the SEC filed its lawsuit.

Today, as the FBI continues to investigate the fraud and a court-appointed receiver sifts through the wreckage of McLeod's empire, looking to recoup whatever remains of the money, his victims aren't in a forgiving mood. The bond fund that they were told was yielding them tax-free 10 percent returns never existed. A group of them started commiserating via e-mail, discussing how they fell for the ruse and wondering if they will ever see any of their money again. Many are embarrassed, knowing full well the irony of a federal agent, trained to spot frauds, being robbed blind.

How McLeod won his contracts and was given so much freedom to visit federal offices remains a mystery. Spokespersons for the Office of Homeland Security, which includes ICE and Customs and Border Protection under its umbrella, declined to comment or didn't return calls. The FBI, where McLeod gave seminars at its Quantico (Va.) training center and for 10 different field offices, including Boston and New York, says the decision to bring him in had been made by the local leadership.

The FBI also issued a statement about Mueller's use of McLeod's Amelia Island condo: "Director Mueller contracted with a property management company to rent vacation condominiums on Amelia Island occasionally over the past several years," said spokesman Michael Kortan. "The management company may at times have provided a unit owned by Wayne McLeod, as well as units owned by other individuals at other times." Kortan added that the FBI chief "had no personal or professional relationship with Mr. McLeod, nor did he engage in any financial dealings of any kind with him."

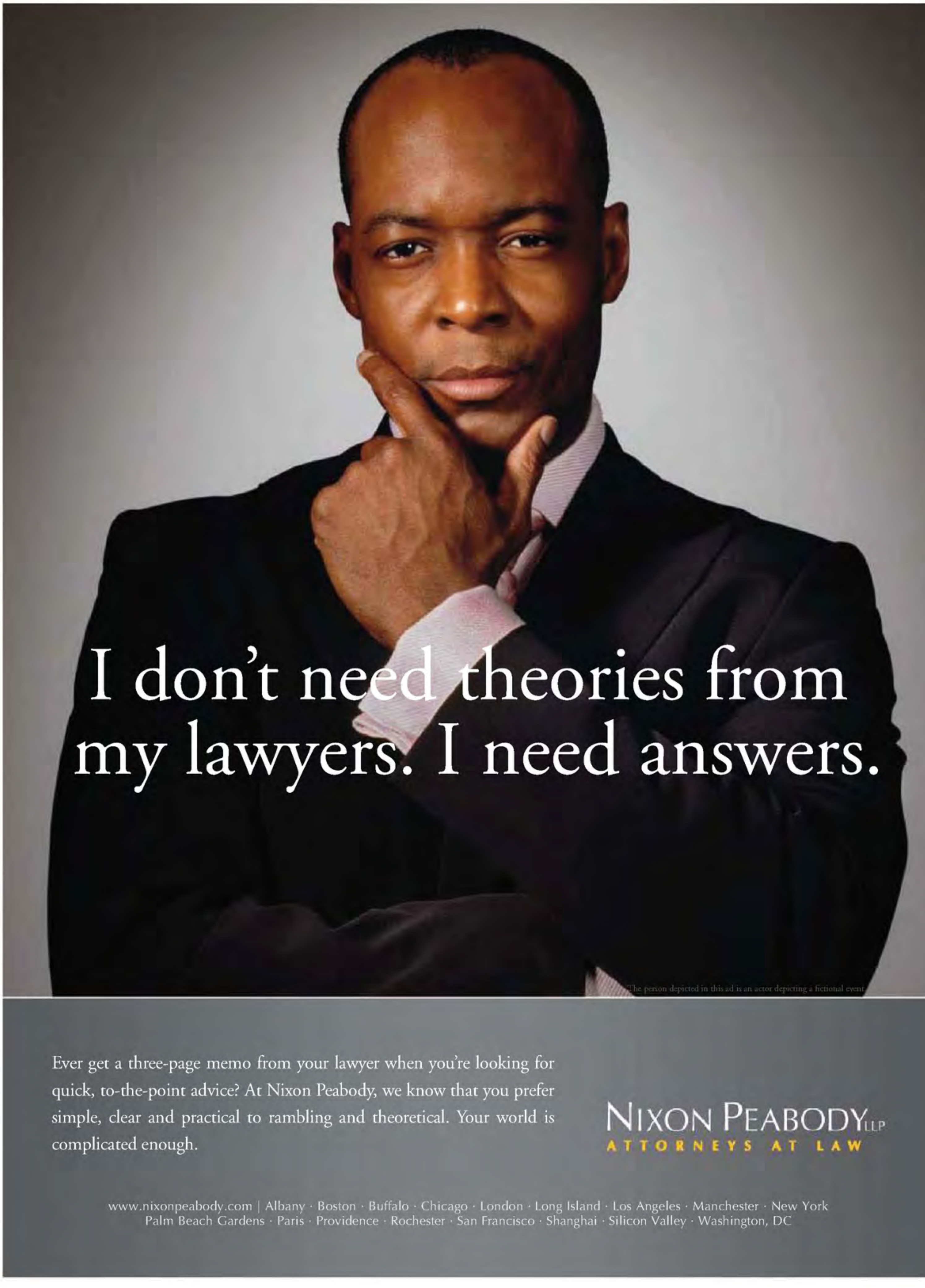
The government's silence on the question of how McLeod was able to conduct the fraud is frustrating to some of his victims, and some wonder privately if their employer is concerned about its liability. That's one area that Michael Goldberg, the court-appointed receiver, is probing in his effort to recover money for the victims. Goldberg, a Fort Lauderdale attorney and expert in Ponzi schemes, says there doesn't appear to be much money left. He's preparing to ask the court to give him the proceeds from McLeod's life insurance policies and has sold off what is left of his office equipment. Goldberg says the case is more disturbing than most. McLeod wasn't promising outrageous returns, he notes, and the agents seemed to be relying on the approval of the government when they signed up with the investment adviser. "These are the guys that put their lives on the line every day for us," Goldberg says. "Their employer brought the wolf to the sheep."



"These are the guys that put their lives on the line every day for us," says Michael Goldberg. "Their employer brought the wolf to the sheep"

Shortly before 11 a.m. on June 22, five days after McLeod confessed to the SEC, a single gunshot rang out in Mandarin Park, a quiet, wooded area on the St. Johns River in Jacksonville where families come to barbecue and boaters are warned to steer clear of the manatees that swim along the coastline. Arriving at the scene seconds later, officers from the local sheriff's office found a middle-aged man slumped behind the wheel of his black Hummer, with a handgun nearby. The doors were locked, and the keys were still in the ignition. A bullet hole had pierced the driver's side window.

Wayne McLeod's suicide was an inglorious, though perhaps predictable, end for the father of five with a hidden life that had just come crashing down on him. Over the weekend before McLeod's death, many of his clients were frantically trying to get in touch with him, spooked by a vaguely worded mass e-mail he'd sent notifying them that he was shutting down the special fund they had put their life savings into. In words no investor wants to read, McLeod had written: "I pray that at some point in time you can and will forgive me."



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Opening Remarks

The Good Old Bad Days

It's easy to be nostalgic for the 1990-91 recession that gave way to the Clinton boom. What will it take to ignite that kind of growth today? By Caroline Baum



The U.S. economy remains almost comatose. ... The current slump already ranks as the longest period of sustained weakness since the Great Depression. ... Once-in-a-lifetime dislocations ... will take years to work out. Among them: the job drought, the debt hangover, the defense-industry contraction, the [banking] collapse, the real estate depression, the health-care cost explosion and the runaway federal deficit.

That's how *Time* described the dismal state of the U.S. economy—in September 1992. The passage has been making the rounds in financial circles, a token reminder that today's pessimism—the forecast of a "lost decade" for U.S. employment by Pimco CEO Mohamed El-Erian, for example—may turn out to be too extreme.

Almost before that *Time* article reached the recycling bin, the U.S. economy was humming again. Real gross domestic product rose 4.3 percent, both in the fourth quarter of 1992 and on a year-over-year basis—and for the rest of the decade America never looked back. The recession that officially ended in March 1991 lasted just eight months, one of the shortest U.S. downturns ever; it took another year to produce consistent job growth. Soon, however, the jobless recovery that helped elect Bill Clinton in 1992 ushered in a decade of prosperity, with 23 million new jobs created. By the spring of 1997, unemployment had fallen below 5 percent—a 24-year low—yet inflation was holding steady at around 3 percent, with consumer confidence near an eight-year high. No wonder Clinton was beginning a second term.

Could it happen again? When it comes to financial markets, pessimism is a buy signal. Just when the outlook is bleakest, when investors have liquidated their stocks or sold them short, markets tend to turn up. Can the same be said about economic pessimism?

One should never underestimate America's capacity for self-renewal, its spirit in the face of adversity. The unexpected Clinton-era boom owed a lot to a technology-driven leap in productivity growth, which had slumped to about 1.5 percent from the mid-1970s to mid-1990s, then bounced back to 2.5 percent. Right now it's hard to see what might come along to goose U.S. productivity in the same way, but to quote Melanie Griffith's character in the George H.W. Bush-era movie *Working Girl*, "You never know where the next big idea might come from."

That said, there are good reasons to believe a 1990s-style surprise—strong job and economic growth—won't materialize in this decade. The foundations for growth that were in place then are missing now.

Take declining deficits. The end of the Cold War saw defense spending fall from 5.2 percent of GDP when Clinton took office to 3 percent in 2000. At the same time, the tech bubble of the last half of the 1990s and a capital-gains tax cut in 1997 produced a revenue windfall for the U.S. Treasury as investors took profits. Personal income taxes as a share of GDP rose to a record 10.2 percent in 2000 compared with a more typical 8 percent. The federal government posted its first budget surplus in almost three decades in 1998. It wasn't until 2002 that wars, tax cuts, recession, and a less ebullient stock market conspired to bring the deficit back with a vengeance.

DIRCK HALSTEAD/TIME & LIFE PICTURES/GETTY IMAGES



The Duke of Disco

It's Michael O'Leary's world; we're just flying in it. The reliably outrageous CEO of budget airline Ryanair is remaking commercial air travel in his image: shabby, crabby, and cheap, cheap, cheap.
By Felix Gillette



"Why does every plane have two pilots?" asks Michael O'Leary, chief executive officer of Ryanair, the largest low-cost airline in Europe. Wearing sneakers, jeans, and an off-the-rack short-sleeved shirt, O'Leary is pontificating in his office at the company's conspicuously shabby headquarters on the outskirts of Dublin Airport.

"Really, you only need one pilot," he continues. "Let's take out the second pilot. Let the bloody computer fly it." What happens if the pilot has a heart attack? One member of the cabin crew on all Ryanair flights would be trained to land a plane. "If the pilot has an emergency, he rings the bell, he calls her in," O'Leary says. "She could take over."

From time to time, O'Leary, 49, lets loose with a statement like this—a reliably provocative idea about how he'd like to make air travel cheaper by doing something seemingly nutty. It's easy to dismiss his comments as the calculated ravings of a headline hound, but to do so would be to miss an opportunity to peer into the airline industry's psyche, which is usually hidden behind a phalanx of smiling, innocuous faces. At moments like these—or later, when O'Leary explains how he'd like to introduce standing cabins and pay toilets on all his flights—he gives voice to the industry's most primal survival instincts. He is the id of the airline business.

If times were lush, rival airline executives could afford to ignore him. But in recent years, with much of the global industry struggling to survive, O'Leary's subversive vision



looks increasingly like a viable alternative to the status quo, which is threatened by obsolescence, attrition, and consolidation. He says what the others are thinking, and, more often than not, doing.

These days, any commercial flight may leave you with the impression that airlines consider you cattle. Only O'Leary will call you a cow, lick his chops, and explain how he plans to carve you up for dinner. His 17 years at the helm of Ryanair have been one long feast. During an era in which the bulk of the commercial airline industry has lurched from one crisis to another—from the attacks of September 11 to the April explosion of the Eyjafjallajokull volcano in Iceland to the ongoing global recession—Ryanair has grown from a tiny regional airline into a legitimate powerhouse with 7,000 employees, flying 1,100 routes to 155 airports in 26 countries. In July, Ryanair became the first airline in Europe to carry more than 7 million passengers in one month. The company has a market cap of $7.2 billion, dwarfing competitor easyJet ($2.3 billion) and Ireland's legacy airline Aer Lingus ($612 million) but still falling short of Southwest ($8.29 billion) and Delta ($8.22 billion). Over the past decade, at a time when the global airline industry collectively lost nearly $50 billion, Ryanair turned healthy net profits in 9 out of the 10 years—most recently earning $431 million in the fiscal year ended in March.

None of this guarantees that any of O'Leary's wilder fantasies will ever be realized, only that his ideas will shape air travel for years. Beneath his success as a CEO is a radical reassessment of the nature of the commercial air traveler—a reclassification that has gained momentum over the years, evolving from fringe hypothesis to near-universal theorem. At the heart of the O'Leary philosophy is the idea that commercial air passengers are not delicate creatures whose repeat business depends on free pillows, blankets, and tea. Rather, they are hardy beasts—parsimonious when buying a ticket, profligate once in the air—willing to endure discomfort and indignity just so long as they get to their destination cheaply and with their suitcases. The question hanging over the airline business and passengers alike is not whether the O'Leary Way will be further adopted by airlines scrambling for survival but how far and fast his paradigm will spread.

In July 2002, passengers in England were boarding a Ryanair flight bound for Dublin when the pilot announced that the baggage handlers loading the plane were short-staffed. A major delay was imminent, the pilot said, unless people volunteered to move luggage. Soon after, a handful of passengers stepped out on the tarmac to heave bags onto the plane.

Someday, O'Leary would like to see this on all Ryanair flights. "Airports are ludicrously complicated places only because we have this utterly useless transaction of taking your bag from you upon departure, just so we can give it back to you at arrival," he says. "Get rid of all that crap. You take your own bag with you. You bring it down. You put it on."

O'Leary believes that the way airports are designed to handle baggage is a cumbersome vestige of a bygone era, dating to the years between world wars when the only people flying were the likes of the Vanderbilts and Roosevelts. "They

were switching out of the presidential suite on the cruise ships, where they had a whole team of flunkies with white gloves who carried their bags, and onto Pan Am, where they expected the same thing. Well, sorry. It's 2010. Carry your own bag." O'Leary brags that Ryanair was the first airline to charge for luggage: "For a small little Mickey Mouse Irish airline, the whole industry around the world now watches what we do."

O'Leary has a dream: that someday all passengers will fly for free on Ryanair and that all of the company's income will come from ancillary revenue, such as baggage fees, in-flight sales, and commissions on travel insurance, hotels, and car rentals sold through the carrier's website. It's a distant dream. Ancillary sales make up only 20 percent of the airline's revenue. The litany of people and institutions he believes are standing between him and his dream includes trade unions (who drive up costs), politicians (who favor state-run airlines), and regulators, who prevent him from enacting efficiencies such as flying short flights with one pilot.

"If you don't approach air travel with a radical point of view, then you get in the same bloody mindset as all the other morons in this industry: This is the way it has always been, and this is the way it has to be," says O'Leary. "So nothing changes."

In exchange for cheap fares, he says, passengers will put up with just about anything. On Ryanair, that can include high luggage fees; relentless in-flight sales pitches for smokeless cigarettes and scratch-off lottery games; minimal customer service; bad, expensive food; cramped seats; and flights to secondary city airports that are sometimes hours from the actual city. (A $34 one-way ticket from Dublin to Frankfurt, for instance, will actually take you to an airport in Hahn, Germany, which is nearly two hours by bus from Frankfurt proper.) Eventually, O'Leary would like to get rid of two of the three toilets on all short flights, which would allow Ryanair to pack in more passengers at lower fares. He would charge passengers one euro to use the remaining toilet. "In many ways, travel is pleasant and enriching," O'Leary says, leaning back in his chair. "It's just that the physical process of getting from point A to point B shouldn't be pleasant, nor enriching. It should be quick, efficient, affordable, and safe."

He puts his feet up on the table and gestures at his sparse office, which doubles as the staff meeting room. Hanging on the wall is a 2010 Ryanair charity calendar, featuring the airline's flight attendants in bikinis. Otherwise, the CEO's office could pass for a facility in an office park in New Jersey. The drab, 15,000-square-foot space, O'Leary says proudly, is "probably the smallest headquarters of any airline in the world." While the idea of sprucing up his work environment is repugnant to him, he'd like to renovate all 250 of Ryanair's Boeing 737s. Earlier this summer, he announced that he was planning to replace the last 10 rows of seats on his aircraft with 15 rows of upright "standing seats"—vertical benches with shoulder harnesses and arm rests—which would allow him to pack 30 more passengers onto each plane.

The idea of vertical seats has been a third rail in commercial air travel since 2006, when *The New York Times* published a controversial front-page story about how aircraft manufacturers were considering using the contraptions. After publication, executives at Airbus played down their reported interest. "Our passengers and customers want more and more comfort," an Airbus spokeswoman told CNN at the time. Afterwards, the *Times* printed a lengthy correction, and in the interceding years passengers proceeded to do the opposite of what Airbus predicted, ceding more and more traditional comforts to airlines looking to boost their ancillary revenue.

O'Leary now says that after taking a look at the drawings, he has decided vertical seats won't save enough room. Instead, he has a better idea—replace the last 10 rows with a standing cabin, outfitted with various handrails, much like a New York City subway car, only without the benches and the panhandlers. The increased capacity, he says, would lower fares by 20 percent to 25 percent. "In no plane ever operated by Ryanair will it be all standing. You will always have the choice of paying for a seat," he says. "The argument against it is that if there's ever a crash, people will be injured. If there's ever a crash, the people in the sit-down seats will be injured, too."

O'Leary downplays the threat that turbulence would presumably pose for standing passengers. "Yes, somebody could get injured," he says. "I don't say that lightly. But we'd do exactly what we do in every other case: 'Ladies and gentlemen'—BING, BONG—'we're going to have some slight turbulence. Hold on to the rail tightly.' "

"He insults the dignity of the flying public every time he opens his mouth," says Kate Hanni, the founder of FlyersRights.org, a nonprofit passenger advocacy group. Hanni says that this past May, spurred by O'Leary's comments about pay toilets, she raised the issue during a meeting with the U.S. Transportation Dept. DOT officials told her they had verbal commitments in place from all the major U.S. aircraft manufacturers that they will never have pay toilets, she says. "We would pursue enforcement action against carriers as an unfair practice if they imposed a fee for using on-board toilets," confirms Bill Mosley, a spokesman for the DOT. Hanni says she will press officials for similar assurances against standing-room cabins.

As for the solo pilot idea, Patrick Smith, a longtime pilot and essayist, calls the notion "beyond preposterous." Smith says that O'Leary is stoking the common misconception that planes more or less fly themselves. "Even in routine operations, it's important to have a second person there," he says.

"What we don't want is to have Ryanair's wild and foolish ideas trickle into the U.S.," says Hanni. "What we've seen is that passengers freak out for a few minutes, and then they become resigned."

O'Leary was born in March 1961, the second oldest of six sib-lings. His father was an entrepreneur who had a series of ventures, including a textile business, a meat rendering plant, and a rabbit-breeding operation. Although his family was well-off—O'Leary attended Clongowes Wood, the same prestigious Irish boarding school that once graduated James Joyce—they never flew anywhere. Until the mid-1980s when Ryanair came along, Aer Lingus, Ireland's national airline, had a near monopoly on flights out of Dublin, and prices were high. Like most upper-middle-class families at the time, when the O'Learys traveled overseas, they did so by ferry. Looking back, he can't remember when he first got on an airplane. "Obviously, it wasn't that fantastic an experience. It wasn't like losing my virginity."

After graduating from Trinity College Dublin with a business degree, O'Leary worked for several years as a tax accountant at a large firm. He left to start a newsstand chain that, according to the biography *Michael O'Leary: A Life in Full Flight*, by Alan Ruddock,

"Air transport is just a glorified bus operation"



PREVIOUS SPREAD: AFP/GETTY IMAGES; AP; BLOOMBERG; CORBIS; GETTY IMAGES; RETNA; REUTERS; ZUMA PRESS (7). THIS SPREAD: AP; RETNA

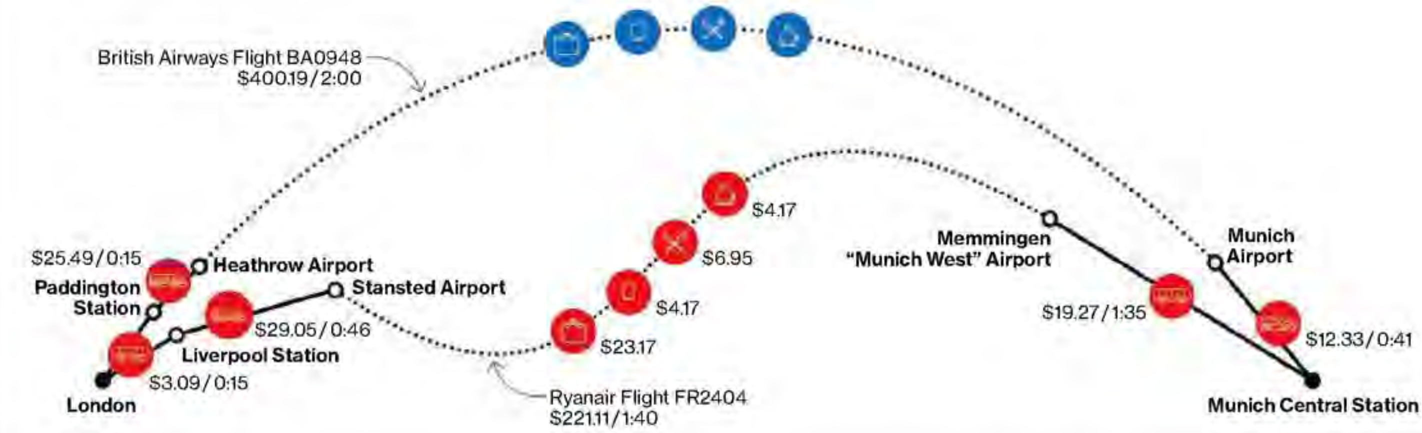
The real cost of a Ryanair flight vs. one on British Airways from London to Munich



	Total hours	Total cost
British Airways	3:11	$441
Ryanair	4:16	$311

● Included

● Out of pocket



netted the entrepreneur a couple hundred thousand Irish pounds in two years.

In 1987 he took a job as a financial assistant to Tony Ryan, an entrepreneur who had made a fortune in aircraft leasing and who had recently started an airline, based at Dublin Airport. (Ryan died in 2007.) O'Leary agreed to work for no base salary and a significant percentage of Ryanair's earnings, should the airline's meager fortunes ever improve. The deal eventually made him one of Ireland's wealthiest men. He currently holds 55 million Ryanair shares valued as of Sept. 1 at $5.05. For the first several years of its existence, though, Ryanair struggled. Several times, O'Leary recommended that it be shut down.

Until 1994, when he became CEO, O'Leary was fairly conventional. He avoided the limelight. He wore blazers. He was largely unknown, even to the Dublin press. After stepping into the top job, though, he realized that a low profile was bad for business. He saw how other flamboyant airline executives saved advertising money by generating loads of free publicity. Herb Kelleher embodied the fun-loving experience that he was selling with Southwest; Richard Branson channeled a sense of adventure, which he used to market Virgin Atlantic. O'Leary chose to embody the role of a cheap, no-nonsense, slightly unpleasant Everyman, which he would exploit to sell a cheap, slightly unpleasant flying experience to the Everyman.

He ditched his tax accountant wardrobe and started showing up for work in jeans. At Ryanair headquarters, he cultivated a reputation for penuriousness, banning cover sheets on faxes and requiring employees to buy their own pens.

O'Leary worked hard to become known as the most unpleasant man in Ireland. He pulled off obnoxious stunts, including dressing up as the Pope to launch a route to Rome and riding a tank into an airport outside London. He took out advertisements insulting high-ranking government officials, including a series of infamous ads in 2001 depicting Mary O'Rourke, then the nation's top transportation official, first in a bubble bath ("Mary, Mary quite contrary," read the ad, "How does your monopoly grow? It doesn't") and later as a cowgirl, under the headline, "Welcome to Dublin Airport. This is a stickup!" During interviews and radio appearances, he further insulted public figures, once calling Ireland's former Taoiseach (the equivalent of Prime Minister) Bertie Ahern, a "useless wastrel."

In his spare time, O'Leary breeds racehorses and cattle on his estate outside Dublin, where he lives with his wife and two children. He is a keen student of animal genetics and disposition. He would never mistake, say, a Beefmaster for a Belgian Blue. But O'Leary says that for decades, airlines have been mixing up their breeds of passengers–treating cheap budget travelers as though they were corporate tycoons, handling them with a level of courtesy they neither receive anywhere else in their lives nor truly expect.

Ryanair has become infamous for its customer service, which some would characterize as minimalist and others have described as hell. Complaints must be sent in by fax, not e-mail. Passengers have grappled with surprising surcharges for using such things as wheelchairs. Newspapers including *The Guardian* have created reader competitions dedicated to describing Ryanair horror stories.

Despite it all, more and more people are flying Ryanair–which, in the end, might be the ultimate validation of O'Leary's assessment of what travelers really want. "One of the great MBA-speak ideas is that the customer is always right," he says. "The customer is usually wrong. The only time you hear from a customer is when they're usually complaining because they want to break our rules. Why can't I get a refund for my non-refundable ticket? Bugger off."

Back in his office, O'Leary was growing impatient. The id of the airline industry is no fan of self-analysis. He's hinted in the past of someday stepping down from the company, though he says he has no plans for life after Ryanair. Political office is out of the question. "I'm unelectable," he says. Writing a memoir is of no interest. "I don't waste any time pulling wool out of my navel, analyzing my life," he says.

O'Leary finds questions about legacy equally annoying. "I'm not in it for the pride of how I served mankind," he says. "Would I like to see a statue made of me? Absolutely not."

He did concede one point of pride. "We finally exposed the myth that air travel was some kind of a uniquely sexual experience," he says. "It's not. It's just a commoditized way of getting from A to B." B

DATE: FLIGHTS FOR SEPT. 24 BASED ON ROUNDTRIP FARES. DATA: BLOOMBERG; NOWFLY

Gastronaut

While his celebrity-chef peers slap their names on frozen pizza and theme-park chow halls, Ferran Adrià is taking the high road—to Harvard.

By Colman Andrews



When Ferran Adrià—who has been called the world's greatest chef by enough people that it might be true—appears at a gastronomic conference at Harvard University on Sept. 8, it will be as a "brand ambassador" for his native Spain. The Spanish government earmarked €9 million in 2009 (then about $13 million) to promote gastronomic tourism and indigenous food products internationally, and the Spanish tourist office, Turespaña, estimates that more than 10 percent of the 52 million tourists who visited Spain last year were drawn by its food and wine. Thus it's sending Adrià—whose legendary El Bulli restaurant in Cala Montjoi, not quite 100 miles north of Barcelona on the Costa Brava, is open only six months a year, costs about $340 per person, not including wine, and is all but impossible to get into—around the world promoting a simple message: If you like to eat and drink, come to Spain.

The night before the conference, Adrià, 48, will take part in a program called "Science and Cooking: A Dialogue," held in conjunction with Harvard's School of Engineering and Applied Sciences. This is the first in a semester-long series of seminars and classroom demonstrations in which top contemporary Spanish and American chefs and assorted academics, mostly from the fields of chemistry and physics, will come together at Harvard to discuss and illuminate topics ranging from "Olive Oil & Viscosity" to "Heat, Temperature & Chocolate." The point is to combine the rigor of science with the unfettered creativity of contemporary cuisine—theoretically to the benefit of both disciplines.

The series is part of a much larger, multifaceted Harvard-based collaboration, conceived and directed by Adrià, who, though he has no scientific training of any kind, has revolutionized modern cooking through the development of widely copied "scientific" techniques like spherification (which encloses food essences inside bubbles made of themselves, like a pea ravioli in which both filling and "pasta" are made of nothing but peas) and the production of culinary foams and airs. Most of his innovations came about through trial and error. (In an early foam attempt, he blew pressurized oxygen directly into a ripe tomato and ended up splattering the walls.) Now he seeks to understand the physical and chemical principles on which his art is based, and to share that understanding with his colleagues.

It's unconventional territory for a chef, though not for Adrià, who has spent much of the past decade redefining what the title means. In 2003 he co-founded the Alícia Foundation, a food-related research and educational institution jointly sponsored by the Catalan government and Caixa Manresa, a large regional savings bank. He helps run it along with Catalan-born cardiologist Valentín Fuster, ex-president of the American Heart Assn. and now director of Mount Sinai Heart in New York. Adrià won the 2006 Raymond Loewy Foundation's Lucky Strike Designer Award, which typically goes to design-world luminaries such as Philippe Starck and Karl Lagerfeld, and participated as a conceptual artist in the 2007 edition of Documenta, a large international art show held every five years in Kassel, Germany. And early this year he announced he will soon become a chef without a restaurant: El Bulli will close at the end of the 2011 season, reopening two years later as a "think tank" (he uses the term in English, a language he doesn't really speak) which he says will be "open to ... all avant-garde gastronomy lovers: chefs, sommeliers, front-of-the-house professionals, gourmets, creative thinkers, or solely enthusiasts of our dream."

1961
Dr. Hans Schilling, a German vacationer, opens a minigolf course in Roses, Spain.

Like many chefs who have become world famous in recent years—Wolfgang Puck, Mario Batali, Alain Ducasse, Alice Waters, and Gordon Ramsay, to name a few—Adrià doesn't merely prepare food. He's an author, endorser, consultant for major corporations, and, though less than most, a TV talking head. More than any of his peers, though, Adrià has invested the proceeds of his celebrity in the creation of new ideas about food. The Harvard collaboration is not a new direction—it's the continuation of a career spent in rigorous pursuit of innovation. A good deal of the work goes on not in the kitchen at El Bulli but in a Barcelona workshop, where the art and science of Ferran Adrià undergo constant reinvention.

In the late 1980s, when entire evenings would pass without a single diner walking into El Bulli, a friend of Adrià's asked him why he stayed in such a remote spot. "Because I have an idea," the chef replied. "And it's a good idea."

A decade later, with the dining room packed every night, Adrià put resources behind his idea. He purchased an entire floor of an 18th century townhouse on

"WILL YOU EAT RABBIT BRAINS?"

That's one of the questions they ask when you call to make reservations at El Bulli. Otherwise, you eat what they give you, about 35 separate courses. The cost, without wine, is about $340 per person. Here, an account of the author's recent meal:

- **Sake sorbet with yuzu foam and tonic.** Tart and bracing—a kind of pale sorbet soda in a tall glass. Wakes the palate right up.
- **Nori-trias.** Black nori seaweed made crisp and crackly, like pâte feuilleté, then folded around black sesame butter—sort of a peanut butter cracker elevated to perfection, with an Asian accent.
- **"Easter egg" of frozen coconut milk with curry powder.** A large white globe of frozen coconut milk, almost like a thin layer of firm frosting. A server cracked it open at the table and sprinkled on the curry powder. It was to be eaten in shards. Strange but good.
- **Passion fruit "orchid."** Thin slices of the fruit turned into three crisp, bright, yellow-orange petals with a sweet carpel of hazelnuts and passion fruit essence—as fragrant as an orchid.
- **Pine nut bonbons.** Racy-looking bitter-sweet chocolate globes, each with a single pine nut extending from it like a nipple. Very tasty.
- **Gominola of shiso.** Vinegary little sour plum candies with a strong taste of minty shiso leaves, jellied and a little chewy in texture. Not my thing. (Gominola is Spanish for Gummi bear.)
- **Galetas of tomato and Parmigiano.** Medium-thin cookies, one of each ingredient. I would have liked a few more of both.
- **Amaranth with hazelnut oil.** A little round of pan-toasted amaranth leaves anointed with hazelnut oil. Nutty and ethereal.
- **Miso turrón with walnuts.** Extraordinary, like a real turrón (halvah-like Spanish nougat) but cold, salty, and sweet.
- **Peking crêpes** and crab and soya wontons. The former were like fried soup dumplings with impossibly thin skins, filled with liquefied sesame with a touch of heat; the latter were sweet and salty, with some peppery microsprouts on top for texture. I could have eaten a plateful of either.
- **Braç de gitano and beet essence.** The braç de gitano (literally, Gypsy's arm), traditionally a rolled sponge cake filled with cream, was made with a feather-

1975
After Spanish dictator Franco dies, Schilling asks, "Why not make El Bulli a gastronomic restaurant?"



Yes, those hands belong to chefs, and no, that's not a science experiment—it's the El Bulli kitchen

the Carrer de la Portaferrissa, a clamorous pedestrian shopping street linking Barcelona's medieval Gothic Quarter with its famous Las Ramblas in the city's heart. The process of designing, renovating, and equipping it took more than a year, and the elBulli Taller opened in January 2000. (The word, pronounced "tal-YEH," is Catalan for "studio" or "workshop," like atelier in French.) Together, El Bulli and the workshop lose more than half a million euros a year, a deficit made up by Adrià's other ventures.

Throughout 2009, I spent a number of mornings and afternoons at the Taller, asking questions, watching the chefs work, and snooping around (with Adrià's permission). On my second or third visit it dawned on me that, for a real chef, working at the Taller is a dream job: Adrià's deputies come in every day to play with food. Everything is fair game, every culture, every ingredient, every technology.

1964
Minigolf proves a bust, and Schilling upgrades the snack bar into Rotisserie Hacienda El Bulli.

It's not all play, of course. Chefs are required to keep extensive and detailed records of everything they do, the failures as well as the successes—on paper and with digital cameras. They also take careful notes when they're out and about, traveling abroad or just roaming around Barcelona or the Catalan countryside. Back at the Taller, all the notes are transferred to a large master notebook and used as a nondigital database of ideas.

Another notebook catalogues the results of extensive testing for dishes are being seriously considered. Each one gets its own page, with name and principal product, date of testing, *valoración* (positive or negative), description/elaboration, field (new product, technique, technique applied to product), and ideas for usage (as dessert, as cocktail, integrated into a dish).

The Taller functions when El Bulli is closed, traditionally from October to April, with a team of about a dozen chefs working in morning and afternoon shifts; Ferran once estimated that about 5,000 experiments might be conducted here annually. Out of that, perhaps 100 or so new dishes would make it into the restaurant. In the mid-2000s, an independent marketing study estimated that running the Taller costs about €250,000 a year. More recently Adrià has said that the Taller and the restaurant run an annual deficit of €500,000 annually, adding that "without the Taller, El Bulli as it is today would not be possible." He adds, "What's important is that we do this every day, every day."

One afternoon at the Taller, after Adrià left me free to poke around, I leafed through some of the notebooks stacked and scattered on a high table. One contained a list of new products—or products that the kitchen had thus far used very little—for possible future use. These include (parenthetical notes are mine):

Olluco *(a potato-like Andean tuber, Ullucos tuberosus Caldas, sometimes used instead of potatoes for chuño, the ancient freeze-dried staple of Peru and Bolivia)*
Mini vegetables
Crosnes *(also called Chinese artichokes)*

weight beet meringue filled with whipped yogurt. It came with one of El Bulli's funny little spoons—mostly bowl, with a wisp of handle—full of concentrated beet reduction.

- **A single grilled strawberry flavored with gin and juniper.** Didn't do a thing for me.
- **Chervil tea.** Served tableside by one of the chefs, who performed a kind of tea ceremony. Two chrome bowls on wooden stands were placed on the table; into these he spooned a fine powder of dried chervil, then whisked in very hot (not boiling) water. We were instructed to drink from the bowls. Tasted like medicine.
- **Gorgonzola mochi.** A creamy little morsel, snowy white and glistening, in which the traditional Japanese pounded rice paste had somehow been turned into a skin so delicate that it almost broke on the way to the mouth; inside was a subtly blue cheese-flavored liquid. Satisfying after that chervil tea.
- **Black sesame sponge cake.** So light in texture that it seemed to countermand some basic law of physics, with a creamy, savory miso paste interior. Perfect balance of salty and sweet. Remarkable.
- **Oyster leaf with vinegar dew.** The gray-green leaves of *Mertensia maritima* were known popularly as lungwort before the menu writers got hold of them. Their new name is no cheat, however; they really do taste like oysters. The presentation here was a single leaf per person, each bearing a few drops of amber-hued shallot vinegar. Pretty, like something in a jewelry ad, but not particularly appealing.
- **Razor clam Laurencia.** A single raw razor clam on the half shell, the other half shell filled with a concoction of ponzu jelly and crunchy, slightly iodine-y red Laurencia seaweed. Very Chinese tasting. Not bad.
- **Umeboshi.** Adrià's version of the traditional sour-salty Japanese pickled plums.Wrapped in nori seaweed, moistened with plum juice and green and bitter almond oils. Strong flavors, not entirely pleasant.
- **Parmesan dumplings with tallarines.** Mildly cheese-flavored soft dough wrapped around barely cooked sea-bright miniature clams. Very good.
- **Baby cuttlefish with pesto ravioli.** Three triangular pale green ravioli—the pesto was "spherified," forming both the ravioli wrapper and the filling—with a lightly cooked little cuttlefish; dots of its ink accented the plate. Just plain delicious.
- **Mandarin flower**

PREVIOUS PAGE: FINLAY MACKAY/JED ROOT. THIS PAGE: MARIBEL RUIZ DE ERENCHUN

Boniato *(sweet potato)*
Carambola *(a.k.a. star fruit)*
Cider apples
Carissa *(a tart berry, Carissa macrocarpa, sometimes called Natal plum)*
Toasted soy flour
Japanese fruit and rice vinegar
Oregano flowers
Ham shoulder fat
Veal throat
Chicken cartilage
Fresh hare from the Vall d'Aran
Thrushes
Espardenya *(sea slug)* ***skin, whole espardenyes***
Giant razor clams
Bottarga Trikalinos *(Trikalinos is a company producing gray mullet; bottarga is dried, cured roe sacs)*
Umeboshi *(Japanese pickled plums)*
Katsubuchi *(Japanese dried fish flakes)*
Nori fried with sesame

Later that day, after Adrià returned, I noticed that on a big calendar pinned to a bulletin board he has blocked out certain days for (his favorite word) "creativity."

How can you plan to be creatively inspired on a certain day? I ask. Don't ideas come when they want to come?

He shakes his head. "No, no, no, no."

Says Adrià: "You have to actively look for inspiration. On this level, you don't just sit and wait for the bulb to go off. The work of creativity is very, very difficult. It's very complicated. Ideas aren't creativity. You look for them and you make notes. After the ideas, with the notes you start to make cuisine. I'm interested in speaking of the synthesis of creativity. It's a very animal thing, the capacity for synthesis. During the creative process, I think only of creative cuisine. It's like hibernation, as if I'm in a monastery."

1983
Ferran Adrià, 21, a plasterer's son from near Barcelona, does a *stage* in the kitchen at El Bulli.

Most of the time at the Taller, I sit on a wide, low-back red leather chair at a glass-top metal table, actually two pushed together, at the terrace end of the kitchen, just observing. Oriol Castro, Ferran's right hand, is there most days, as is Mateu Casañas, present-day head of the "sweet world," and two other key members of the El Bulli creative team, Eduard Xatruch and Eugeni de Diego. Now and then one of the crew disappears to walk a block to the Boqueria, Barcelona's extraordinary main covered market–in effect the Taller's walk-in refrigerator and storeroom, stocking most of the foodstuffs the chefs need.

One day somebody brings in a burlap bag full of snarled, dirty asparagus roots. Castro peels a piece, cuts it into bits, and passes them around. It has a faint licorice flavor but makes the back of my throat tighten. Will the roots end up on the El Bulli menu in some form? I ask. "We don't know yet," says Castro. This is the religion of the Taller: approach every ingredient, every combination, every technique with an open mind and discover the possibilities.

Castro explains that he's been working with the concept of the "twist"–as in the twist of lime or lemon garnishing a cocktail. "The aroma of a twist of orange. ... ," he begins. "If you put the twist with something like sautéed shrimp, you wouldn't remember the orange because the shrimp flavor would predominate. But if you did it with a bite of simply cooked potato, you would have the 'flavor' in your nose instead of in your mouth." He likes the idea of foods "tasted" by aroma. "You must respond emotionally to food," he says. "When I smell mushrooms, I smell the country, the cellar of my grandparents. It's memory-emotion."

1987
Adrià, just 25, takes over the kitchen, starts spending a lot less time chasing Swedish girls at the nearby disco.

Another day, Castro is stirring different thickeners into iced consommé to see which one yields the best texture–traditional sheet gelatin, agar-agar, two kinds of carrageen. "We started with the idea of something Ferran saw in Japan," he explains. "It was a sheet of *nori* with *toro* inside, but it evolved into a kind of wonton. We had the idea to put cream whipped with curry powder inside a wonton wrapper made with transparent gelatin." Later, he and one of the other chefs pour gelatin into indentations made in white silicone blocks by different foods–mussels, shrimp, mushrooms, even rabbit brains, one of Ferran's favorite ingredients.

You're working with gelatins today, I say as Adrià walks by.

"No," he replies, "we're working with molds. First the concept, then the flavor."

The most important job of the Taller, he explains, isn't to create new dishes but to develop new ways of making dishes.

Castro later shows me a new version of *cabell d'àngel*, literally angel's hair, a traditional Catalan confection of candied winter squash used to fill pastries. This one is made not with squash but with gelatin and agar-agar flavored with honey. Adrià brings over a bowl of broth with what appear to be the short Cata-

sorbet with pumpkin oil, pumpkin seeds, and mandarin seeds. A dramatic transition from the previous two dishes; a frozen custard, not very sweet, served in a hollowed-out white cube.
- **Spherified Parmigiano gnocchi.** Very light "pasta" with a pronounced Parmigiano flavor. Sauce of concentrated hazelnut oil overpowered it.
- **Anchovy with truffle.** Good anchovies are one of Spain's great food treasures; they don't need truffle oil.
- **Tomatoes and basil.** A wonderful example of how Adrià reinterprets familiar flavors. Confit cherry tomatoes, dehydrated and injected with olive oil, looked like chocolate-glazed profiteroles (they were coated in black olive oil with dots of balsamic vinegar); with them were fake "olives" fashioned out of puréed Japanese black garlic, and "basil leaves" made of dried caramelized mango coated with basil water powder. A triumph.
- **Coco with caviar.** A yin-yang presentation of coconut milk and thickened coconut water topped with three small spoonfuls of real caviar. Off the wall, but appealingly so.
- **Lulo.** This is a high-acid tropical fruit from Colombia (*Solanum quitoense*), with a citrusy, faintly metallic character. It had been concentrated into a kind of firm jelly and was served with little clouds of whipped yogurt and dots of unsweetened cacao. Interesting.
- **"Tagliatelle."** Usually served atop the lulo, but in this case a separate course: a coil of noodles made not from flour but from frozen foie gras fat, dusted with crystals of salt. A love-it-or-hate-it proposition. I loved it. Don't tell my cardiologist.
- **Veal tendon.** Like some slow-braised red-cooked Chinese meat dish, rich and very flavorful, served in a tarragon-scented broth, then followed by a small, tiny-handled spoon of bone marrow soup. Really good.
- **Abalone.** Thin-sliced baby abalone, the pieces interleaved with wisps of ham fat, surrounded by black Codium seaweed, ginger jelly, golden enoki stems, hazelnut oil. ... Too much going on, could never get the dish in focus.
- **Soup of mango and begonia flower tea.** Thin, aromatic fruit punch. Okay.
- **"Nenúfars."** A soup, based on elderflower syrup, that looked like a tiny, yellowish lily pond; the pond was inset with "water lilies" of nasturtium leaf and (very bitter) Australian finger lime and with brittle-like cashew rock and little pink and white flowers preserved in sugar. Floral and sharp. Didn't love it.
- **Pork tail.** Sweet meat, mahogany in color,

lan noodles, called *fideus*; they're actually made out of cheese, he tells me, through a process similar to spherification.

The next day work continues with the silicone molds, this time with forms of peanuts, hazelnuts, almonds, and chestnuts. "First comes the concept," says Castro, echoing Ferran, "like the chassis on a car. Then we build on it."

Ferran comes into the kitchen. "The chefs here are an independent team," he tells me. "This year I'm not here very much. I just come in and taste." His younger brother, Albert, was in charge of the Taller, Ferran says, "but he has pulled away. He has said before that he is leaving to spend more time with his family [he and his live-in girlfriend of 18 years have a 3-year-old son], but he has absolutely quit this time.... " He pauses. "But little by little he is coming back."

1997

El Bulli gets its third star, the most awarded by the Michelin guide. "We had no party to celebrate," says Adrià.

Later in the morning Albert comes in. There had been rumors that he'd had some kind of rift with Adrià, though every time I'd seen them together they were engaged—physically close to each other, talking with passion, throwing out ideas, gesturing, smiling. Today, though, he and Adrià start arguing heatedly. Then I realize what they're arguing about is soccer.

"Do you ever think about closing El Bulli?" I ask Adrià one afternoon in mid-2009 as we sit outside in the small garden behind the Taller. "Every day," he replies almost before I've finished the question.

As early as 2004, Adrià told an interviewer that he was considering a one-year sabbatical. In 2006 a story in *Nation's Restaurant News* stated unequivocally: "This past season was Adrià's last in the kitchen—at least until 2008, when he will decide what to do next." In 2007, Adrià announced that "at the end of 2008, I am leaving my diary empty."

Yet he kept coming back to both the Taller and El Bulli as involved as ever. "The years from 2003 to 2009," he said in 2010, "were just fantastic!"

He also told me, in 2009, that he was taking things year by year. "I want to continue as long as I have the dream and the passion," he said, "but I want to reinvent myself. The 160 or so days that we keep the restaurant open are very hard. There are those who think we're privileged because we open for only six months a year, but when you make creative cuisine, the pressure is very strong. If we didn't do it this way, I could sit on the beach in peace all day and just go to the restaurant every afternoon at six, no problem." At the time, he dropped some hints as to what the future might hold. "The structure of the restaurant continues to change," he said. "It's possible that next year we will be open only three months, but seven days a week. Or maybe we need 10 months of creativity and just two months of restaurant. For me it would be the same. We could also have just one, two, three tables only, and take no reservations at all. We would select the people who would come, gastronomes who appreciate our cooking. It would be only a way to show how we are evolving. This is all just something I'm thinking about. In any case, El Bulli exactly as it is today will not continue for more than two or three more years. We have to always raise the level. There are 50 possibilities."

Adrià added, "Maybe I'll take a sabbatical not just from El Bulli but from everything. El Bulli and I will both be 50, more or less, in 2012. It opened as a minigolf in 1961, but the *chiringuito* was built and they started serving food in 1962, the year I was born. That would be a good date for me to close the restaurant, but not permanently. I'd like to be able to travel, not for work, maybe to spend six months in Japan and six months in China with my wife. Of course, that's just what I think today. And then sometimes I think 2012 will be the end, period."

Early this year, Adrià made it official: El Bulli would close in May 2011.

2010

Adrià announces that El Bulli will close in 2011, to reopen in 2014 in some evolving form.

That he is shutting down his legendary establishment isn't really a surprise. Ferran himself had admitted frequently that his creative pace was lagging. "Every time, it takes more to innovate," he remarked one day. "Today to create new things takes four times as long as it did 10 years ago." Maybe the rise of El Bulli will turn out to have been like the uncovering of some vast new oil reserves; they'd keep our internal combustion engines going for a few more decades, but ultimately, they were a nonrenewable resource. **B**

Excerpt from *FERRAN: THE INSIDE STORY OF EL BULLI AND THE MAN WHO REINVENTED FOOD* by Colman Andrews. Published by arrangement with Gotham Books, a member of Penguin Group (USA) Inc. Copyright (c) 2010 by Colman Andrews. Gotham Books will publish in October.

crunchy and superb, alongside a ham soup with melon, cilantro, jasmine drops, and carnation flowers. Elegant evocation of prosciutto and melon.

- **Green walnuts with endive.** An almost recognizable version of the classic salad, with a jumble of soft, herbaceous walnuts glazed in Roquefort, out of which rose a bud of red-tinged Belgian endive upended like a rocket about to be launched.
- **Sea anemone 2008.** Just your everyday mix of sea anemone, raw rabbit brains, oysters, and calamondin (a sour-sweet Southeast Asian citrus) in lukewarm dill broth. A food blogger described this creation as "Vile. Vomitous. Nightmare!" I found it so unpleasant and cacophonous that I wondered whether Adrià had gone off the rails. It made my teeth ache.
- **Game canapé.** Duck foie gras and hare sauce made into a paste and spread on a bitter cacao cracker. Very good, despite the ghost of truffle oil in the background.
- **Flower canapé.** A bar of meringue topped with tiny but pungent yellow-green Sichuan pepper blossoms and two or three other kinds of minuscule flowers. Neither refreshing nor very flavorful. I could easily have skipped it.
- **Honey caramel.** A crisp wafer of caramelized honey and sunflower seeds glistening with bitter arbutus honey. Brilliant, a perfect confection.
- **Elderberry juice.** Just that, with honey water jelly stirred in. Tasted like bubble bath.
- **"Autumn landscape."** Sculpture on a plate, an evocative scene built from spice bread, licorice, frozen chocolate powder, and cherry sorbet, all excellent and all in surprising harmony. A truly memorable dessert, beautiful to look at and a joy to eat.
- **Morphings.** What would be called mignardises in a French restaurant or pequeñas locuras (little follies) in Spain, something to go with the coffee—in this case, 25 or 30 little candies and confections, most of them chocolate, presented in a beautiful, dark-wood treasure chest (sometimes jokingly referred to as the "Caja [box or strongbox] Willy Wonka"). I managed a few, including a dark-chocolate-framed mint leaf, a chocolate flavored with eucalyptus, an airy but crisp chocolate-yogurt sponge, a bit of freeze-dried peach coated in dark chocolate, and a couple of branches of chocolate "coral," given color by sour cherry powder. All were impeccable.

1993
Clinton inherited a weak economy —and the seeds of recovery



Today federal coffers remain ravaged by the recession that started in December 2007. A combination of falling tax revenues–individual income taxes fell to a 60-year low of 6.2 percent of GDP–and soaring government spending produced a $1.45 trillion deficit last year. Fiscal 2010, which ends Sept. 30, is expected to show a marginal improvement in the deficit to $1.3 trillion, according to the Congressional Budget Office's August outlook.

The deficit hole comes just as the baby boomers are starting to retire. Life expectancy is increasing at the same time as the ratio of workers to retirees is falling.

The more resources devoted to keeping Gram and Gramps in the style to which they have become accustomed, the less there is to invest in the future: in new technologies that will raise productivity growth; in the education of our children to enable them to compete in a global workforce; and in plants and equipment that increase the economy's productive capacity. Without these investments–without a 1990s-like burst of productivity growth–the U.S. will find it hard to fulfill its promises to future generations and, at the same time, provide an environment that nurtures the entrepreneurs of the future.

There is one parallel between 2010 and the Clinton era. In political terms, this election year is shaping up to be a lot like 1994, when the Republicans wrested control of both houses of Congress from the Democrats. It was the first GOP majority in the House in 50 years.

Right now it's hard to see what might come along to goose productivity the way technology did in 1995

In response, Clinton moved to the center, something that many business leaders would welcome from President Barack Obama. Rightly or wrongly, many blame the current confidence slump on Obama and the Democratic Congress. A fiscal policy in flux is not conducive to entrepreneurship.

America's challenges, however, go well beyond its political class. As a nation, we demand more in benefits than we're willing to pay for in taxes. If we aren't won't compromise, we'd better find a way to grow the pie.

One way would be real tax reform–scrapping the Internal Revenue Code and replacing it with something simpler and flatter. Forget targeted tax cuts, which simply create more opportunities for gaming and more business for lobbyists. Just think how much more productive businesses would be if they spent the same time and money on their products and services that they do on influence peddlers and lawyers.

U.S. businesses and households will devote over 7.5 billion hours this year to complying with income tax laws, according to the National Taxpayers Union's "A Taxing Trend" report for 2010. For individuals, the total compliance tab, including the value of their time and the cost of tax preparation, amounts to $103 billion.

"Given the huge amount of expense our overcomplicated tax system imposes on us, fundamental tax reform would be one of the best ways imaginable to stimulate our economy without plunging the country further into debt," writes David Keating, senior counselor at the Taxpayers Union. He advocates replacing the "current mess" with a flat tax or national retail sales tax. Congress, of course, is not about to relinquish its power over the tax code. America would need a national grassroots movement and perhaps a constitutional amendment to force through such a reform. That would be a worthy final act for the baby boomers–and it might help bring back the boom. ❸

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Bloomberg Businessweek

Michelle Obama's favorite Goldman alum? Page 74

Playboy & Jewelry & The Gobi & Stanford

Etc.

John Deere doesn't just make tractors. It buys art, too. Page 72





Wall Street's New Sobriety

"Sell night," the Street's annual ritual of hosting steak dinners and strip-club expeditions, is over. At least for now. *By Roben Farzad*

Photograph by Guido Vitti

Etc. Sell Night

In late July, Goldman Sachs hosted an exclusive dinner for recent college graduates at a Ruth's Chris restaurant in midtown Manhattan. While the chain steakhouse might have seemed déclassé for veteran Wall Street traders accustomed to 21 or Delmonico's, it was a big draw for bright-eyed recruits who may never know such grandeur. Some even checked the menu online in anticipation.

Once upon a pre-TARP age, late summer on Wall Street meant that top recruits were filling their schedules with company-underwritten evenings at New York's top restaurants. "They would take us to Yankees games, and we thought that was huge," says Allison Levine, a former Goldman Sachs trainee and founder of leadership consultancy Daredevil Strategies. Other firms hired buses equipped with leather sofas, strobe lights, disco balls, and karaoke machines to shuttle invitees to the VIP lounges of exclusive downtown nightclubs. Lincoln Town Cars would take others to the champagne rooms of adult entertainment emporiums Scores and The Penthouse Club. Some could even enjoy a relaxing "booze cruise" on the Hudson or East River. Amid such settings, free-spending senior bankers would pitch the recruits on the benefits of their firm over another.

This time-honored ritual, known as "sell night," provided megabanks and boutiques alike with the perfect backdrop for tendering their professional compact. Senior bankers would offer their firm's prestige and hefty starting salaries–and the implicit promise of future extravagances–in exchange for two to three years of uninterrupted work.

In the postlapsarian summer of 2010, however, fresh hires and interns on Wall Street are settling for Ruth's Chris or–more often–nothing at all. "I remember the old days," says Luis M. Yanez, managing director of Los Angeles-based investment firm Wellworth Capital and a veteran of big nights out on Goldman, Merrill Lynch, and others. "Being flown to Miami, thousands on dinner, clubs, bottle service, nice wine. No expense seemed like too much. Now it's hard to get taken out for a burger, fries, and some beers."

None of these lavish outlays ever made much of a dent in the bottom line. However, banks' fear of appearing profligate after taking taxpayer dollars has, to the chagrin of an emerging generation, ended sell night. Or, to take an optimistic view, put it on hiatus. "The booze cruises, models, and bottle service are history," reports Alison Seanor, a managing director at Wall Street headhunter Glocap Search. "The glory days are gone–at least for now." Says Danny Sarch, a veteran bank talent scout who runs Leitner Sarch Consultants: "It's a different era. You can't be seen as wasteful or irresponsible. Not now."

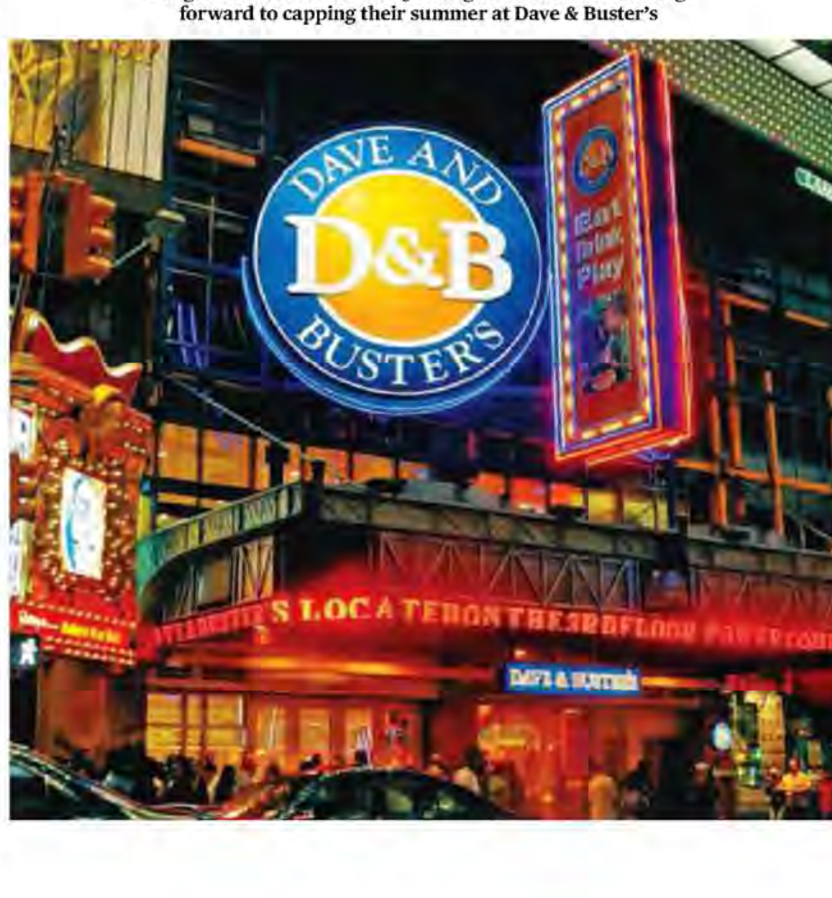
Jenny Van Leeuwen Harrington, a former Goldman broker and current chief executive officer and portfolio manager of investment boutique Gilman Hill Asset Management, says many of her former colleagues remain "extremely hesitant" to expense legitimate networking meals at posh restaurants. Some even prefer paying out of pocket to having swanky establishments such as Abe & Arthur's appear on their expense reports. "They don't want to risk being seen there," she says.

If you get busted for entertaining at The Penthouse Club, you might as well go work for Amway

Being written up in the *New York Post*'s Page Six for dining at the meatpacking district restaurant is one thing. These days, however, it's generally understood that if you're busted for entertaining at The Penthouse Club, you might as well go work for Amway. "Deutsche Bank does not approve of adult entertainment of any kind and will not repay such expenses," read a 2008 directive from the firm that also instructed traveling bankers to shower at the airport instead of paying extra to check in early at their hotels.

As a result, many businesses are experiencing a noticeable drop-off in revenue. Earlier this year, steakhouse Smith & Wollensky took out a full-page ad in *The New York Times* inviting investment bankers to pay their bills with stock certificates. "It used to be no big deal," says Angelina Spencer, a former Penthouse Club owner who is executive director of the Association of Club Executives, a trade group for adult venues. "Now you just don't see the corporate cards and the several-thousand-dollar parties. Wall Street is certainly a lot shyer." Says Michael Cetta, manager of Sparks Steakhouse and a fellow victim of sell night's demise: "Anyone who tells you business has not fallen off is either crazy or lying."

Forget Delmonico's. Some JPMorgan traders are looking forward to capping their summer at Dave & Buster's



JACKSON LEE/SPLASH NEWS

By paying for the sins of their forebears, the aspiring new guard of Wall Street has lost out on what once seemed a birthright. "Dinners these days, whether you're a young prospect or a client, are so few and far between," says Yanez. "The banks are so afraid of getting into trouble."

Wall Street's new sobriety has already had a pronounced effect on recruits. All of those interviewed for this story refused to give their names for fear it would cost them a job offer. With fewer openings than in years past, each spot is hotly contended. Even so, no one wants to be caught celebrating when their colleagues are left in tears without an offer—especially those who have served their second internship. While the situation may not be what it was, "it looks worse than ever to complain," says Yanez. "Trading and banking jobs are not easy to come by."

Consequently, interns and young traders are celebrating much more modestly. UBS hosted a trivia night at an Irish pub featuring free appetizers. One group from JPMorgan recently planned a celebratory trip to Philadelphia to play skee ball at arcade chain restaurant Dave & Buster's. They considered splurging on a Zipcar—until scrapping the idea when so few received offers.

Glocap's Seanor says sell night has morphed into the "sell drink" instead. Increasingly, young analysts, bankers, and traders—who make the endeavor cheaper, she says, because they prefer beer to hard liquor—take prospective hires out to make a take-it-or-leave-it case for their bank. Even the private equity shops and hedge funds that Seanor scouts for have largely scotched their spirited woo-fests. In better years, she says, a finance whiz playing the scene in Manhattan could schedule at least 20 such invitations. This year, she estimates, the average is barely five.

According to Sarch, there are two reasons for this demise. First, Wall Street's resurgent entrepreneurialism has led to the rise of investment boutiques, such as Fieldpoint Private Bank & Trust and HighTower, that have startup-like cost structures and expense policies. Second, bulge-bracket firms such as Goldman can recruit overqualified, recently laid-off bankers without overextending themselves. "People are anxious to get a job," he says. "You don't have to do the kind of wooing you used to."

Interns aren't the only ones losing out. To preserve remnants of a fleeting culture, many veteran bankers have resorted to "soft-dollar" solutions. One recent trend is including recruits on lavish steak dinners—hosted by the firm's clients.

Alas, for all the promise of Goldman's dinner at Ruth's Chris, only drinks and hors d'oeuvres were served, blindsiding the veteran traders who showed up to mingle with the recruits. After leaving the party, one candidate consoled himself with a $5 footlong sandwich from Subway on the train ride home. "You feel for the new hires," says Yanez. "It's gone from one extreme to another." B
—*With Sommer Saadi and Alexandra Wolfe*

From Town Cars to Zipcars: The Way Wall Street Lives Now

The fear of ostentatiousness in a post-TARP age has subdued sell night, the splashy evenings during which Manhattan banks lure recruits. The high life, then and now:

Then		Now
 **Town Car**	← *Mode of transportation:* →	 **Zipcar**
 **21 Club**	← *Choice restaurant:* →	 **Subway**
 **The Penthouse Club**	← *After-hours venue:* →	 **Dave & Buster's**
 **$200 Johnnie Walker Blue Label**	← *Preferred lubricant:* →	 **Watered-down $5 pint of Bud Light**
 **AmEx Black Card**	← *Golden ticket:* →	 **Metrocard**
 **Bottle service at a nightclub**	← *Pastime:* →	 **Trivia Night at an Irish pub**

STEAK: CUTOUTMOEMENTS/ALAMY; SANDWICH: C SQUARED STUDIOS/GETTY IMAGES; SHOE: COSTON STOCK/ALAMY; DARTBOARD: KUTAY TANIR/GETTY IMAGES; BEER: FOODCOLLECTION/GETTY IMAGES; CHAMPANGE: BRAND X PICTURES/GETTY IMAGES; GAME PIECES: RICCARDO SERGNESE/ALAMY

Franz Ackermann at Cowboys Stadium





The Dallas Cowboys
The team's new stadium features 21 large-scale pieces



Playboy Enterprises
Hef's collection includes works by Dalí and Warhol



A Warhol souvenir from a 1986 cover

Cleveland Soul by Jaume Plensa





Cleveland Clinic
The 4,000-plus-piece collection was enhanced by a recent Sotheby's sale

Where Cowboys Meet Conceptualists

What do John Deere, Bayer, and the Dallas Cowboys have in common? They all collect art. *By Lindsay Pollock*

When Dallas Cowboys fans hit the concession stands this season, some may find themselves beneath a 118-foot-wide yolk-yellow geometric mural, *Unexpected Variable Configurations: A Work in Situ*, by French conceptual artist Daniel Buren. It's a significant piece in Cowboys Stadium's collection of 21 large-scale artworks. "It has exposed the sports fan to art," says Brett Daniels, a Cowboys spokesman, "whether they like it or not."

Banks, law firms, and insurance companies have long used art collections to appear sophisticated and amply capitalized, but when the financial crisis hit, many companies were forced to downsize or liquidate. Others have resisted, recognizing the importance of art to their corporate identity—even if, like the Cowboys, that identity has absolutely nothing to do with art.

Corporate collections, however, often emerge simply because the CEO likes art. Bayer's collection has grown to include 5,500 works since the pharmaceutical conglomerate's first managing director, Carl Duisberg, began collecting German Expressionists like Max Beckmann. Paintings by James Rosenquist and Salvador Dalí line the walls of Playboy Enterprises' Chicago headquarters because "Hef has a love of art and a great eye," says Playboy curator Aaron Baker. Hugh Hefner didn't set out to collect art, but when the magazine commissioned artwork, he sometimes bought the results. That's how the bow tie-wearing Andy Warhol bunny—a souvenir from the January 1986 cover—entered the trove. Baker says the Warhol is "priceless" to Playboy. If you need to put a figure on it, a monumental 1986

HEFNER: DAN TUFFS/GETTY IMAGES; HELMET: SCOTT BOEHM/GETTY IMAGES; STETHOSCOPE: RYAN MCVAY/GETTY IMAGES



Celebrity Cruises
Ships include iPad tours of the cruise line's collections



John Deere
The company began purchasing art to complement its Saarinen headquarters

La Chaine Simpson was designed around 1896





Blue Inflorescence by Bhakti Baxter



Red in the Centre by Ernst Wilhelm Nay



Bayer
The German company has amassed a 5,500-piece collection over nearly 100 years

Warhol *Self-Portrait* fetched $32.6 million at Sotheby's in May.

In other cases, it's the boss's spouse who does the collecting. Christina Chandris, the spouse of Celebrity Cruises co-founder and Chairman John Chandris, cooked up a plan in the mid-'90s to outfit three ships with art. She acquired works by Marina Abramovic, who recently staged a nude show at New York's Museum of Modern Art, and German photographer Thomas Ruff, best known for his blurred images of Internet porn—not the normal family cruise decor. Despite being acquired by Royal Caribbean International in 1997, three new ships include over 400 unique works apiece. The piano bar in the *Equinox* even has a Louise Bourgeois print of her signature spider. Ships offer "self-paced" iPad tours for travelers tired of waiting on the buffet line.

Collections are also spawned by new offices. In 1964, farm equipment manufacturer John Deere moved to a new headquarters in Moline, Ill., designed by renowned architect Eero Saarinen. Subsequently, CEO and Chairman William A. Hewitt installed a 2,000-piece collection that includes modernist artists Alexander Calder and Henry Moore. One thematic concession: Grant Wood's 1931 *Fall Plowing*, with a steel plow, invented by John Deere, in the foreground. Perhaps as surprisingly, the Cleveland Clinic has three curators overseeing its 4,086-piece collection. Curator Joanne Cohen has acquired 1,896 new works since 2006, partly funded by a 2007 sale of a $2.5 million Milton Avery painting at Sotheby's.

The austere climate has given rise to new, less expensive solutions for corporate collectors. Alexander Glauber, a former curatorial assistant at asset management firm Neuberger Berman, has launched Corporate Art Solutions, which rents artwork for six-month periods, with an option to buy, based on its retail price. "It allows companies to focus on connecting with the art," says Gauber, "instead of worrying about the cost." Or worrying about getting a reptuation for being broke. B

BOTTLE: JOE KOHEN/BLOOMBERG VIA GETTY IMAGES

After Goldman, Gold and Diamonds

Péan's company makes 1,000 pieces a year. The current collection ranges in price from $320 to $203,840 for a 33.4 carat diamond bracelet

Tragedy led Monique Péan to make jewelry. Now Michelle Obama wears her pieces



Goldman Sachs may not have a lot of friends in the White House these days, but one of its former employees has made a good impression. After three years as an analyst in Goldman's fixed-income, currencies, and commodities division, Monique Péan began her own jewelry line that can now be found in Barneys, Jeffrey New York, and around the neck of Michelle Obama.

In the summer of 2003 the University of Pennsylvania grad took a job at Goldman, arriving for work each day by 5:30 a.m. Two years later her sister died in a car accident, and Péan began making jewelry as a form of therapy. The hobby persisted, and Péan, now 29, spent $30,000 of her savings to buy a piece of fossilized woolly mammoth tusk from the Arctic Circle as material. When she wore a necklace made from part of the tusk into boutique Scoop NYC, the store manager took notice. Péan said she'd made it herself, and the manager asked to see a line sheet. "I had no idea what a line sheet was," says Péan.

Scoop's interest inspired her to approach more stores, and within six months, she left Goldman to pursue her own jewelry company, Monique Péan Fine Jewelry, sourced from artisans from around the world. Los Angeles' Milk boutique became the first retailer to carry her line. For two years she ran the company by herself, eventually hiring the consultancy firm Launch Collective to help her with marketing, sales schedules, and philanthropy (she donates $20 to $30 from each piece to the organization Charity: Water). In late 2009, Péan eased the load by taking on an angel investor, which enabled her nine-person New York-based company to expand its production to 1,000 pieces a year that range from $320 to $203,840 for a recycled rose gold, 33.4 carat diamond bracelet.

Thanks to two industry awards—and buzz following Obama's decision to wear a Péan necklace to a state dinner—the business has grown 136% in the past year. Barney's carries her line in eight of its national stores. "At Goldman I followed currencies and commodities," says Péan. "Now, I find myself doing the same thing. I'm constantly tracking the price of gold." Ⓑ —*Alexandra Wolfe*

Péan's natural pink tourmaline necklace with 18-carat recycled yellow gold sells for $10,580 at Barneys New York



FROM FINANCE TO FOSSILS

$80,000
Price of most expensive material in Péan's current line (antique diamonds)

4,000+
The company helped provide clean water to this many people last year

5
Pieces of 12,000-year-old fossilized woolly mammoth tusk in showroom

2,241
Number of Herkimer diamonds at Péan's headquarters in New York

DATA: MONIQUE PEAN FINE JEWELRY

TOP: PHOTOGRAPH BY MARTHA CAMARILLO FOR BLOOMBERG BUSINESSWEEK; BOTTOM: VICTORIA WILL

Etc. Hands On

The Cell Guards

Zomm and Phone Halo aim to prevent the agony of the lost cell phone. *By Rich Jaroslovsky*



Certain technology products are unintentionally irritating. The Zomm and Phone Halo—two new gadgets aimed at preventing you from losing your cell phone—are irritating by design. With some 285 million mobile phones in use nationwide, the number of phones that go missing each year is about 30 million, according to Nashville-based cell-phone insurance provider Asurion. Zomm and Phone Halo seek to protect users from the annoyance of having to rush back to the restaurant they left 45 minutes ago.

The Zomm, which costs $79.99, is a circular gadget about an inch and a half in diameter. Once you pair it with your phone via Bluetooth, its large central button flashes every five seconds to reassure you it's still within range. Walk more than 30 feet away and it begins to flash more rapidly, vibrate, and emit an alarm that commands attention. Its center button also operates as a panic button when held down for 15 seconds. First it emits an alarm, and then, if not released, it summons help to the location of your phone. Zomm also incorporates a speakerphone that allows you to answer incoming calls. The sound is fuzzy for regular use, but it's better than fumbling around a large bag for a ringing phone.

The Zomm works with any Bluetooth-enabled phone, but the $59.95 Phone Halo—about the size of a rubber eraser—is currently limited to users of BlackBerrys and phones using Google's Android operating system. (The company says iPhone compatibility is in the works.) Setup is more involved; you first have to download and install the appropriate app on your phone, then configure it. In addition to its audible alarm, you can set it up to e-mail you, or, if you don't mind the embarrassment, to tweet a lost-phone message to your Twitter followers. You can use the Phone Halo in reverse by attaching it to some other object you don't want to misplace, like a briefcase. Separate them too far, and the phone is preprogrammed to play the karaoke favorite *(There's) Always Something There to Remind Me*.

Of the two options, the Zomm does more things and is easier to set up. For iPhone users, the $20 difference is a small price to pay compared with the agony of separation from their beloved gadget. B

i

Zomm and Phone Halo

The Zomm ($79.99) and Phone Halo ($59.95) offer a host of extras in addition to keeping cell phones from getting lost

WHEN PARTING CAN BE SWEET SORROW

Install these apps and you won't worry about losing your phone. —Arik Hesseldahl



Find My iPhone, $99/yr
(iPhone) Locates your phone on a map and messages the person who found it. Free 60-day trial.



Mobile Defense, free
(BlackBerry, Windows Mobile, Android, Symbian) Real-time phone location; IDs a new SIM card. Due this month.



Lookout, free
(BlackBerry, Windows Mobile, Android) Besides finding your phone, remotely backs up and wipes out data.



WaveSecure, $19.99/yr
(Android, BlackBerry, Symbian, Windows Mobile) Locates phone; security options; moves data between phones.

PHOTOGRAPH BY RAINER BEHRENS FOR BLOOMBERG BUSINESSWEEK; COP: SIRI STAFFORD/GETTY IMAGES

The Call of the Wild

A personalized guide to camping–from roughing it to not so much. *By Kurt Soller*



Tenthouse suites at Rockwater Secret Cove Resort



A retrofitted camping trailer at El Cosmico

1. The Mogul



Halfmoon Bay, British Columbia

If your idea of camping doesn't include bugs or dirt, there's a way to enjoy nature from the comforts of a five-star ersatz tent. Your sojourn can even include salmon fishing expeditions and Thai massages.

CAMP: At **Rockwater Secret Cove Resort**, journey down a 1,500-foot forest boardwalk to your "tenthouse suite," which has a private veranda, a fireplace, and heated floors ($215 to $436 per night). The pagoda-like suites overlook the Pacific and are surrounded by the world's largest temperate rainforest, full of grizzly bears hunting in salmon streams. GETTING THERE: It's a 28-minute ride from Vancouver International Airport on a float plane to the remote coast (about $80 each way). EAT: Drive a half hour to **The Blue Heron Restaurant** for seafood and sunsets. Start with prawns marinated in sambuca, followed by local salmon dressed in citrus fruit butter (main courses run from $23 to $35) DRINK: Near the restaurant, **Lighthouse Pub** is no-frills, but its marina views are popular with locals. If you don't want a Molson, stop by the adjacent liquor store for a large selection of regional crisp white wines and bring a bottle back to the resort. SEE: Book a private day with Rob Metcalfe of **Bayside Charters**. He'll take you salmon fishing or crabbing ($460 for four hours) on his fisherman's boat. TIP: Don't skip the hotel's otherworldly spa, where a 90-minute Thai massage–which stretches your entire body–costs about $150.



2. The Young Professional



Marfa, Tex.

The Lone Star State is known for music festivals, tumbleweed spotting, and huge hunks of steak. Marfa, though, is an artist's colony with numerous galleries, great dining, and young tastemakers who don't mind sleeping in yurts.

CAMP: Just outside town, on Highway 67, the recently renovated **El Cosmico** campsite offers retooled trailers with comfy beds ($90 to $125 per night) as well as yurts and teepees that come with futons and lanterns ($60 to $75 per night). You'll likely spend time in the Dutch tubs–outdoor, wood burning hot tubs (about $75 per day)–so long as there's no drought. GETTING THERE: Fly into El Paso (round-trip flights from Chicago, Denver, and Atlanta range between $200 and $400, depending on the season) and rent a car for the three-hour drive southeast. EAT: **Food Shark**, a 1974 bread truck, offers Mediterranean fare such as the Marfalafal, a Texas-size version of the chick pea classic ($5.50). DRINK: **The Famous Burro** bar has Texas beers such as Shiner Bock on tap, and the bartender makes syrups from scratch. SEE: The town's galleries (more than a dozen) showcase everything from minimalist prints at **Inde/Jacobs** to Dan Flavin's light sculptures at the **Chinati Foundation**. Stop by **Prada Marfa**, a replica of a fashion boutique on a desert highway. TIP: The town shuts down on Mondays and Tuesdays, so plan your trip for a weekend. Your cell phone may lose service–and that's the point.



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Living among the giraffes at Safari West


If you want to trek the Gobi, do it with an expert

3. The Family



Santa Rosa, Calif.

The same weather that makes for great wine—it's dry and never gets too hot—also makes for good camping. It doesn't hurt that there are vineyards, 400 different animals, and some innovative restaurants nearby.

CAMP: Bring the kids to **Safari West**, a 400-acre nature preserve that's one of the only places outside Africa where you can see more than 400 different animals, including giraffes, zebras, leopards, antelopes, and nearly extinct birds. You'll sleep in cabin-sized African canvas tents that include a bathroom and bunk beds for the kids (approximatley $350 per night). GETTING THERE: Fly into San Francisco and drive 75 miles north. EAT: Slow food meets Neapolitan pizza at **Rosso**. You'll get both by ordering thin pies with vegetables, cheeses, and meats from Sonoma County farms ($13 to $16 per pizza). If it's on the specials menu, order the oven-roasted Dungeness crab. DRINK: **Siduri**, a Santa Rosa vineyard, offers free tours and a chance to taste their renowned pinot noirs. SEE: The trip highlight will be the Safari Tour, a three-hour introduction to blue wildebeest, cheetah, and scimitar-horned oryx, capped off by a visit to the **Isle of Lemurs**, which teems with the odd creatures ($68 for adults; $30 for children ages 3-12). TIP: Tours are by reservation only and take place rain or shine; unless you normally wear galoshes and ponchos, check the weather report.



4. The Adventurer



The Gobi Desert, Mongolia

For a guide to the region, among the most isolated places in the world, book with U.K.-based extreme-travel specialist Black Tomato. Its eight-day, $6,000 package includes airfare and a guide.

CAMP: Black Tomato's guides will drop you off each night at "ger camps"—large yurts that serve as rest stops for tourists—during the trip. Most of the daytime travel takes place in jeeps, with locals ushering you through the vast plains. Along the way, they'll point out nomadic tribes and indigenous animals, including snow leopards, ibex, camels, and the world's only desert bear, the nearly extinct Mazaalai, which roams near oases to find leaves to eat. GETTING THERE: From Los Angeles, fly 20 hours to Ulaanbaatar, the capital city at the north point of the desert. Your Black Tomato guide will meet you for the trip south into the remote areas. EAT: Rest-stop fare includes both steamed dumplings (buuz) and others deep fried in mutton fat (khuushuur), a staple of the Mongolian diet. DRINK: Fresh water is provided for all campers. SEE: The trip stops in Karakorum, the ancient capital of the country that was once home to Marco Polo. The city that aspired to be a modern metropolis now lies in ruins. Don't miss the 500-year-old temples of **Erdene Zuu**, one of the oldest Buddhist monasteries in existence. TIP: The region has long, freezing winters, so it's best to visit in July, August, or September. B



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1. Based on number of days of performance leadership for the TPC-C, TPC-H 10TB, and SAP 3-Tier SD benchmarks between June 1, 2005, and June 1, 2010. For more information, see http://www.tpc.org and http://www.sap.com/solutions/benchmark. TPC, TPC-C and TPC-H are trademarks of the TPC. BM, the BM logo, ibm.com, DB2, Power Systems, Smarter Planet and the planet icon are trademarks of International Business Machines Corp., registered in many jurisdictions worldw.de. Other product and service names might be trademarks of BM or other companies. A current list of BM trademarks is available on the Web at www.ibm.com/legal/copytrade.shtml. © International Business Machines Corporation 2010.



Don't Care Much About History

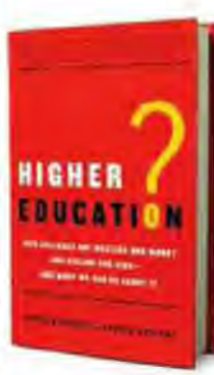
American higher education remains a mess, but there's finally some good news. *By Paul M. Barrett*

Here's something unusual: good news about the $420 billion American higher education business. Authors Andrew Hacker and Claudia Dreifus report that, with an open mind, teenagers and their parents can find any number of surprisingly high-quality, reasonably priced colleges and universities. Forget Harvard. Arizona State, anybody?

The business of shaping undergraduate minds, in the authors' view, charges too much and delivers too little. However, Hacker, a sociologist at Queens College in New York, and Dreifus, a science journalist at *The New York Times*, set themselves apart from other recent chroniclers of the American campus demise by offering constructive advice in *Higher Education? How Colleges Are Wasting Our Money and Failing Our Kids–and What We Can Do About It.*

Higher Education? How Colleges Are Wasting Our Money and Failing Our Kids–and What We Can Do About It

By Andrew Hacker and Claudia Dreifus
TIMES BOOKS,
288 pp, $26



Recent grads and their cash-drained relatives may know some of what's in this volume. For younger, uninitiated families–and old-timers in the foggy grip of campus nostalgia–the book offers a bracing dose of reality. After three decades of tuition increases exceeding the overall rate of inflation, a ritzy college degree comes with a $250,000 bill. Uninspired–and usually underpaid–part-time instructors do 70 percent of the teaching these days, according to Hacker and Dreifus. At the University of Pennsylvania's Wharton School, often described as the country's top undergraduate business program, freshmen in Management 100 are taught, in part, by undergraduates who took the course just a year or two earlier. "Few sophomores," the authors write, "have the fund of information, techniques for coping with questions, or the skills for conducting discussions that college-level teaching requires." Or that Penn's $53,000 annual tuition would suggest.

At many schools, liberal arts students are cast adrift in a curricular sea of the overly vocational (at Ohio State, Turfgrass majors can specialize in either golf course or sports turf management) and the unnecessarily narrow. The authors raise an

ILLUSTRATION BY CHRISTINA UNG

eyebrow over Stanford's 229 undergraduate history courses, maintaining that many of these highly specialized classes simply "make life easier for the professor who often just has to use notes from his last article or the galleys of her next book."

Hacker and Dreifus insist that students with any intention of learning are likely to be disappointed. Carefully steering clear of nativism, they report the dirty little secret that over in the math and science buildings, graduate students imported from China, Russia, and Korea too often lack the English skills to lead classes on physics or calculus. The cumulative results are depressing. Freshmen courses have enormous rates of students withdrawing or failing: 45 percent is common, according to the National Center for Academic Transformation. More than a quarter of all freshmen nationwide never return for their sophomore year.

The authors also observe how conventional universities are coming to resemble for-profit diploma mills through inexpensive, Orwellian-titled "distance learning." At Florida Gulf Coast University on the outskirts of Fort Myers, students in Humanities 2510 sit in dormitories or at home studying painting, sculpture, and architecture via online lectures. Adjunct professors with modest credentials answer questions by e-mail; telephone calls are not allowed. Multiple-choice tests emphasize dry facts and figures. Short papers are required, but students don't have to attend performances or see art in person. In lieu of customized grading, instructors draw on "sample stock comments" they slap on student papers. "Humanities 2510 seems close to cramming for a quiz show," the authors write. To readers, it might just seem like a rip-off.

Hacker and Dreifus harbor radical reform ideas: eliminating tenure, divesting major universities of much of their research operations, trying admission by lottery. Tenure, it seems, is eroding on its own, as schools transition to mostly part-time instructors. The other proposals seem interesting but entirely unrealistic.

Of more use to lay readers are the authors' criteria for making the best of what's out there, as evidenced in their top ten list of worthy schools. Some highlights: Ole Miss has a strong student-centered liberal arts curriculum and an atmosphere of racial reconciliation, the authors write. Cooper Union in New York offers top-flight engineering and architecture degrees–sans tuition. Arizona State University, with 68,000 students, cultivates niches such as its Honors College, where 3,000 undergrads enjoy an intimate liberal arts program at state school prices. Raritan Valley Community College in exurban New Jersey proves that commuter students and part-timers can get an excellent two-year jump start that prepares them for a full-fledged institution.

In future editions of this worthwhile book, Hacker and Dreifus might address how, even at overpriced bastions of pretension, determined undergraduates can still read a few books and challenge themselves intellectually. Sure, most of the tenured professors don't give a damn, but it's a useful life lesson to figure out the ones that do, and take all of their classes. Finally, it's striking that despite the seismic cultural changes of the Internet era, the Ivy League and its cousins retain their aura of superiority. Is it really all just self-importance and clever marketing? I suspect these schools have idiosyncratic strengths that help explain their continued success, beyond mere snob appeal. By all means, send your kid to Arizona State if that appeals. Although Princeton ain't bad, either. ❸

Thinking Beyond The Ivy Walls

Hacker and Dreifus's top 10 "outside of the box" college options



▶ **Arizona State University**
ASU's Honors College "offers 3,000 undergraduates an intimate liberal arts program at state school prices."

▶ **Berea College**
The Kentucky liberal arts school doesn't charge tuition; instead, students are asked to contribute 10 hours of labor each week.

▶ **Cooper Union**
The New York art school's engineering, fine arts, and architecture programs are all free.

▶ **Evergreen State College**
With no grades and no set curriculum, Evergreen attracts slightly older, more mature, and serious students.

▶ **University of Maryland, Baltimore County**
Of all the research universities the authors visited, this one "most capably connected its research functions with undergraduate schooling."

▶ **Massachusetts Institute of Technology**
The school's sparkling reputation aside, its undergraduate experience is enhanced by adjunct professors who are treated well and motivated.

▶ **The University of Mississippi**
The former symbol of segregation is now a school "where reconciliation and civility are at the very heart of the educational mission."

▶ **University of Notre Dame**
The Catholic university "has successfully avoided the faddish academic trends," and grad assistants teach only 7 percent of classes.

▶ **Raritan Valley Community College**
The two-year New Jersey institution caters to commuters and "provides a better introduction to college work than many four-year schools." Classes don't exceed 40 students.

▶ **Western Oregon University**
The former teachers' college has a sterling faculty trained at prestigious schools such as Cornell and the University of Wisconsin.

At one Florida university specializing in "distance learning," students can only e-mail their professors

ILLUSTRATION BY OLIVER MUNDAY

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Joe Plumeri

"Of course I want to get paid. I'm just not going to be paid based on how profitable the business is for the insurer. I don't think it's the right thing to do"

The chairman and CEO of insurance brokerage giant Willis Group on shunning contingent commissions and forgoing hundreds of millions



As an insurance broker, you're supposed to represent the client who's buying insurance. The practice of contingent commissions—when insurers give brokers cash incentives to bring them business—never made me comfortable. Real growth doesn't come from bringing an insurance company more business or profits.

Six years ago, when (then-New York Attorney General) Eliot Spitzer was looking for causes, he picked contingent commissions. When Spitzer raised the issue, I thought we could do away with them. Spitzer targeted the three big brokers: Marsh, Aon, and us. Before we were investigated, I went to see Spitzer and told him I happened to agree that these payments were conflicts of interest. He listened and, later, he went after us. I had expected that. But I assumed he would continue the process and ban all brokers licensed in New York from doing this. After he pursued the three of us, though, he stopped and moved on.

That created an un-level playing field. When it became legal to accept contingent commissions again, Marsh and Aon resumed. Besides an acquired company's program that we're shutting down, Willis is the only one that doesn't take them worldwide. I made this decision in 2004, and I'm sticking to it. At the time, we were taking in about $80 million a year in those fees. I thought our leadership might stimulate others not to take them. Or it might stimulate clients not to allow their brokers to take them. None of that occurred. In fact, when my contract was extended as CEO about six months ago, one analyst said it was bad news for Willis because of my stance on this.

There are analysts who think we're giving up revenue and leaving money on the table. Of course I want to get paid. I'm just not going to be paid based on how profitable the business is for the insurer. I don't think it's the right thing to do. If an agent represents an insurance company, they should be paid by that company. But when you're representing the client who's looking for insurance, that's the person whose interests you uphold. You can't serve two masters. —*As told to Diane Brady*

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Global Economics



Prime Minister Kan: His stimulus plan did not impress the markets

ISSEI KATO/REUTERS

Japan Has More Than Just a Yen Crisis

▶ The Japanese obsess about the currency instead of the economy

▶ "Don't cry about the strong yen, fix the problem"

It's the economy that cried wolf.

With growth slowing, deflation deepening, and the yen inexplicably surging in late August, Japanese policymakers pledged bold action. Bank of Japan Governor Masaaki Shirakawa rushed home from Jackson Hole, Wyo., to deal with the emergency. Investors braced for aggressive intervention. The media mobilized on Aug. 30 to cover Prime Minister Naoto Kan unveiling a fat stimulus package to counter the export-crimping effects of a strong yen. Then–nothing.

Disappointment over token efforts resulted in exactly what Japan didn't want: an even stronger yen, which has gone from 85.2 to the greenback on Aug. 23 to 84.4 on Sept. 1. Suzuki Motor Chairman Osamu Suzuki, who has built a big export business for his company's sturdy little cars, speaks for many when he says of the currency: "I spend every day feeling anxious about this."

So do politicians in Tokyo. That they are at a loss to do anything about it has Japan suffering the same fate as Aesop's boy who warned of crisis so often that no one took him seriously anymore.

As the dollar and euro slide, the yen rises by default. Rarely before has it been so difficult for Japan to control its currency. The yen's jump to a 15-year high says much about where Japan finds itself in 2010. Here are three specific things to consider about Japan's plight.

> **After the boom-and-bust 1980s, Japan opted for Band-Aids such as low rates and a weaker yen**

1) *The price of Japan's aversion to change is going up.* After the boom-and-bust 1980s, the government should have rid banks of bad loans, deregulated industry, made tax policies more pro-business, raised productivity, and encouraged entrepreneurship.

If Japan had done all these things, it would have a much better balanced economy today, and the yen's value would not matter nearly so much. Instead, Japan opted for Band-Aids such as massive government spending, low interest rates, and a weaker yen.

Exchange rates became a particular obsession in the 2000s as Japan focused on its export behemoths to maintain a trade surplus. To their